

Memorandum

To: HJ 35 Subcommittee
Gene Walborn, Department of Revenue Director
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From: Finn McMichael, Tax Policy and Research

Date: July 2, 2020

Subject: Revenue Impact of Statewide Sales Tax

The taxation of the sales of goods and some services is a standard method of collecting tax revenue at the local, state and national level. As of 2020, 45 states within the United States have a statewide sales tax, with tax rates that range between 2.9 percent and 7.25 percent. In addition to the statewide sales tax, 38 states also allow the collection of local sales taxes. Montana is currently one of five states with no general statewide tax. To estimate the revenue impacts that the implementation a statewide sales tax would have in the state, the Department of Revenue currently maintains a sales tax model, which provides revenue estimates based on statewide sales, spending and demographic data. The purpose of this memorandum is to provide information on the general structure of sales taxes, Montana's sales tax model, and revenue estimates based on a couple sales tax structures at the statewide level.

Sales Tax Information

The State of Montana currently generates revenue from several different sources, with transfers from the federal government and state level taxes comprising more than 80 percent of tax revenue. Montana's largest sources of tax revenue are income and property taxes, which comprise approximately 65 percent of state and local tax revenue. Unlike other states, sales and excise taxes comprise a relatively small portion of state and local tax revenue in Montana, at approximately 10 percent of total revenue. For comparison, sales and excise taxes comprise approximately 50 percent of South Dakota's state and local tax revenue. The cause of Montana's relatively low share of sales and excise tax revenue is primarily the lack of a general statewide sales tax.

Conventional sales taxes are levied on the sale of goods and services to the final end user, or consumer. The amount of taxes that are due are based on a percentage of the prices of the goods, or services, which were sold. For example, a consumer purchasing a \$50 appliance from a retail store would pay \$2 in taxes under a 4 percent sales tax. Unlike other consumption taxes, such as a value added tax, the sale of goods and services to a business to be resold later to a final consumer are generally not subject to sales taxes.

The amount of revenue generated by a sales tax is dependent on two main factors, the tax rate as well as the types of goods and services subject to the tax. In the United States, statewide sales taxes range

between 2.9 percent in Colorado to 7.25 percent in California. Montana's surrounding states have sales tax rates of 4 percent in Wyoming, 4.5 percent in South Dakota, 5 percent in North Dakota and 6 percent in Idaho. Local sales taxes can increase the sales tax rates of some areas above their statewide level, with combined rates that approach 10 percent in some states. Montana's tax rate for a statewide sales tax is limited to 4 percent in the state constitution.

The actual types of goods and services covered by sales taxes vary significantly across states. The sale of non-essential tangible personal property is subject to the tax in most sales tax systems. However, the sale of essential items, like non-prepared food and prescription drugs, are usually exempted from sales taxes. Most sales tax systems tax at least some services provided by businesses, and the current trend is to tax more services as the economy has become more service-based over recent years. Overall, the types of goods and services subject to a sales tax has a significant impact on the amount of revenue that is generated by the tax.

A Review of Montana's Sales Tax Model

To generate sales tax revenue estimates, the Department of Revenue developed a sales tax revenue estimation model based on data from the U.S. Census Bureau's Economic Census of Businesses, the U.S. Department of Labor's Consumer Expenditure Survey and the Montana Department of Commerce's population projections. Based on industry data, the sales tax model can project revenue for sales taxes that exclude particular industries or services, such as food sales or medical services. The sales tax model can also project future sales tax revenue based on forecasted consumer spending patterns and population levels. Finally, the sales tax model provides revenue estimates based on various sales tax rates that are proposed in legislation.

To generate its revenue estimates, the department's sales tax model follows a four-step process. In the first step, historical total sales data from the 2012 Economic Census of Businesses is used to provide taxable sales estimates for each of Montana's economic sectors, such as retail sales, construction services and accommodation and food services.¹ As a sales tax does not tax intermediate sales, taxable sales excludes the sale of goods from one business to another. Next, the historical sales data is projected forward using changes to consumer spending patterns, based on the Consumer Expenditure Survey. For the third step, projected sales data is adjusted based on projected changes to Montana's population. Finally, the specified tax rate, non-compliance and vendor allowance rates are applied to the adjusted taxable sales to provide the final revenue estimate.

In the end, the revenue amounts provided by the revenue model are estimates, and are subject to several assumptions and limitations. One of the primary assumptions made by the model is that consumption spending by residents of Montana are comparable to the spending patterns of the United States as a whole. This assumption is due to the lack of state level consumer spending pattern data. Another assumption is that industry sales do not change significantly over a short amount of time. This assumption is necessary, as industry sales data from the Economic Census are only released every five years and must be projected forward.

¹ The 2017 Economic Census data is currently being released and it is available for some industries but not all of them yet. Enough should be released by November 2020 to update the model with the 2017 census data instead of the 2012 data.

Statewide Sales Tax Revenue Estimates

The types of goods and services that are covered under a sales tax has a significant impact on the amount of revenue that a sales tax generates. For example, a sales tax of 4 percent that covered every single end-user good and service in Montana would have the potential to generate \$1.23 billion in fiscal year 2021, according to the department's revenue model. However, no state applies their sales tax to the sale of all end-use goods and services. As a result, the \$1.23 billion revenue estimate is the theoretical maximum amount of revenue a sales tax could possibly achieve in Montana.

Sales taxes in most other states tax the sale of most end-user goods, with the sale of essential items, such as food or medicine, excluded from the sales tax. At the same time, some services are taxed, such as foods sales at restaurants, and recreation services while other services, such as educational and health care services, are not covered under the sales tax. Limiting the types of goods and services covered by Montana's sales tax to those covered by sales taxes in other states would reduce the total amount of revenue generated by a 4 percent sales tax to approximately \$1 billion in FY 2021. FY 2022 and industry revenue estimates are also available for this sales tax coverage level in the Representative columns in the table below.

Statewide Sales Tax Revenue Estimates				
Industry	Representative		Maximum Possible	
	FY2021	FY2022	FY2021	FY2022
Sector 11, Logging, fishing & hunting, ag support	\$0	\$0	\$5,264,729	\$5,374,016
Sector 21, Mining	\$0	\$0	\$30,227,202	\$30,359,853
Sector 22, Utilities	\$0	\$0	\$17,505,341	\$17,725,836
Sector 23, Construction	\$200,530,073	\$203,759,338	\$200,530,073	\$203,759,338
Sector 31-33, Manufacturing	\$0	\$0	\$25,114,078	\$25,685,405
Sector 42, Wholesale Trade	\$0	\$0	\$71,223,539	\$73,718,545
Sector 44-45, Retail Trade	\$598,495,054	\$614,277,897	\$598,495,054	\$614,277,897
Sector 48-49, Transportation & Warehousing	\$20,487,455	\$21,198,022	\$20,487,455	\$21,198,022
Sector 51, Information	\$11,244,424	\$11,691,493	\$11,244,424	\$11,691,493
Sector 52, Finance & Insurance	\$0	\$0	\$54,648,022	\$57,454,482
Sector 53, Real Estate & Rental & Leasing	\$17,196,348	\$17,880,061	\$17,196,348	\$17,880,061
Sector 54, Professional, Scientific, & Technical Services	\$30,884,725	\$32,112,676	\$30,884,725	\$32,112,676
Sector 56, Waste Management & Remediation Services	\$21,638,848	\$22,499,191	\$21,638,848	\$22,499,191
Sector 61, Educational Services	\$0	\$0	\$1,047,373	\$1,099,381
Sector 62, Health Care & Social Assistance	\$0	\$0	\$38,674,055	\$40,928,448
Sector 71, Arts, Entertainment, & Recreation	\$11,607,490	\$12,096,005	\$11,607,490	\$12,096,005
Sector 72, Accommodations & Foodservices	\$138,800,576	\$147,060,755	\$138,800,576	\$147,060,755
Sector 81, Other Services (except public administration)	\$35,149,313	\$36,546,821	\$35,149,313	\$36,546,821
Total Sales Tax Liability	\$1,086,034,307	\$1,119,122,258	\$1,329,738,647	\$1,371,468,225
Net Revenue after non-compliance/vendor allowance	\$1,002,937,083	\$1,033,733,799	\$1,231,851,616	\$1,270,765,520

One of the advantages of a sales tax is that non-resident visitors of the state who purchase goods and services also pay the tax, which reduces the amount of taxes that are paid by residents of the state. In 2019, the Institute for Tourism and Recreation Research at the University of Montana² estimated that non-resident travelers to Montana spent approximately \$3.76 billion in Montana during 2019. The department's revenue model estimates that total sales in Montana to be \$100.6 billion in FY 2019, resulting in non-resident spending comprising approximately 3.7 percent of total sales in the state. Assuming the proportion of spending remains consistent, non-resident travelers could pay approximately \$37-\$47 million in sales taxes for FY 2021 and FY 2022.

Note that the data used to create all the estimates in this memo are from prior to the Covid-19 pandemic, and these estimates do not account for the economic impacts of the pandemic. These estimates represent an average year, and sales tax collections during the pandemic would be significantly lower.

² "2019 Nonresident Visitation, Expenditures and Economic Impact Estimates," Kara Grau, Institute for Tourism and Recreation Research, University of Montana, May 2020