Massachusetts
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Prepayment is Preferable to Daily Sales Tax Remittance

Introduction

As Massachusetts lawmakers look for ways to close a $3.6 billion tax revenue gap in the FY21 operating budget, there is a simple idea that could help the state receive sales tax payments more quickly and provide about $267 million of additional revenue in the year it is implemented. The proposal is the prepayment of sales tax by vendors. This straightforward concept is in sharp contrast to acceleratd sales tax or daily remittance (ASTR), an idea that has been introduced and rejected multiple times in the past, and introduced again by the Baker administration in the Governor's revised FY2021 budget filed on October 14, 2020 (H.2). Despite the many challenges caused by the pandemic, we should not use it as an excuse to enact bad public policy. Daily remittance wasn't a good idea when it was first introduced in 2017, and it remains a bad idea now.

Background

Some taxes, such as sales, meals and room occupancy – are known as trustee taxes because a vendor collects them on behalf of the Commonwealth of Massachusetts from the consumer on taxable goods and services at the point of sale and then turns it over to the state at a later time. In Massachusetts, unlike in 24 other states, the vendor receives no compensation for performing this administrative task.

As a way to raise revenue in the current fiscal crisis, there have been two different proposals to accelerate sales tax, meals tax and room occupancy tax payments to the state. The first provision relates to prepayment of taxes and was included in both Governor Baker's revised FY2021 budget and the House Ways and Means Committee FY21 budget. By adopting some version of this, the state will receive 13 months of sales tax in the year the change is implemented, providing additional one-time tax revenue for that fiscal year.

The second concept relates to a daily remittance of sales tax. It would require credit card processors to remit taxes to the Department of Revenue on a daily basis on behalf of each vendor with which they do business for credit card sales. This language in the Governor's budget (Section 39) would become effective on July 1, 2024. It delegates implementation to the Department of Revenue (DOR) specifying only that this daily remittance obligation will fall to the third-party payment or credit card processors. Given that there have been several iterations of the proposal since first introduced, it is unclear what the proposal could entail. The original version required changing the point of sale technology to capture the applicable taxes at the time of the transaction while another proposal required credit card processors to make the payment on a vendor's behalf as part of its daily batch payment processes. Both versions add complexity and cost to vendors.

Prepayment - the better alternative

In general, prepayment is a straightforward requirement employed by several other states imposing sales tax that enables the state to obtain sales tax revenue sooner but without the cost or complexity associated with daily remittance.

In the Governor's budget, the language allows DOR by regulation to require vendors with annual sales tax liability over $150,000 to make a preliminary or advance payment of the sales, meals or room occupancy taxes and reconcile or "true up" the payments at a later time. This gets the tax revenues into state coffers during the current month rather than on the 20th day of the following month as current law requires without requiring vendors and retailers to upheave current practices. In fact, 23 of the states that impose a sales tax require prepayment of estimated taxes due by certain vendors. In contrast, no state requires daily remittance. The Governor's budget makes the provision effective retroactively to the start of the fiscal year, July 1, 2020.

The HWM budget would become effective upon enactment. It requires vendors with $150,000 in annual sales tax liability to remit on the 25th day of the month the actual sales tax due for all sales that have occurred through the 21st day of the current month. As written, this prepayment proposal is different than the method used by all other states that employ a preliminary prepayment because it requires remittance of the actual amount due, not a percentage of the taxes dues based on the prior year sales or some other preliminary amount. This is an important distinction because it would require vendors to change their software, their processes and their way of doing business to comply.

MTF Position

MTF supports prepayment as a way to address the state's revenue shortfall, but only if: (1) the version of prepayment enacted is clearly spelled out in statute and not left up to regulators, (2) it follows the method employed by other states by requiring an estimated payment in the current month and a final payment in the following month and (3) it is effective prospectively.

What is Daily Tax Remittance?

Daily remittance is a proposed requirement on all Massachusetts retailers, restaurants and accommodation providers and payment processors to remit on a daily basis to the Department of Revenue the trustee taxes they collect from customers on behalf of the Commonwealth of Massachusetts. This requirement would be in addition to the current monthly reporting, not in place of it, as it does not apply to cash transactions and in the case of retailers, does not account for merchandise returns, exchanges and other transactions that occur after the tine of the sale.

Background

Daily remittance was first introduced in 2017 by the Baker Administration in its FY18 budget as one of the ways to address a $1 billion structural deficit. In its original form, the proposal would have upended the global credit card processing system in Massachusetts by imposing Massachusetts-only requirements on vendors at the point of sale to identify which portion the total sale was subject to tax. It was estimated to cost over $1 billion to implement. The legislature did not adopt the provision, instead requiring DOR to study the issue. After receiving testimony from retailers, financial institutions and others overwhelmingly opposed to the proposal due to its cost, complexity and the fact that Massachusetts would be the only taxing jurisdiction with such a requirement, DOR concluded that it was not feasible to implement in the timeframe required by the legislative language. It has been re-introduced in different forms since then, most recently in Governor Baker's FY21 revised budget. The current version applies only to vendors with annual sales tax obligation of $150,000 or more and extends the requirement to meals, marijuana and room occupancy taxes in addition to sales tax. The language effectively leaves implementation up to the DOR, rather than specifying the requirements in statute.

Proponents of this notion indicate that daily remittance will substantially enhance tax revenue collections and minimize fraud, while allowing the state to get the float on the money rather than the vendor. At first glance, all of these reasons sound like good justification for making the change, but upon further examination, one realizes that several other sales tax issues are being conflated with daily remittance (zapping, under-reporting of cash transactions) making the benefit of this policy change greatly overstated.

Here's why:

1. <u>Revenue projections vastly overstate the revenue associated with this change.</u>

The DOR has not provided a publicly-available revenue estimate for this portion of the Governor's proposal; however, proponents of this idea, some of whom have a self-interest in the provision, are claiming that it will result in $770 million in additional sales tax revenue to the Commonwealth based on a study conducted by Performance Economics (PE study). [1] Of this $770 million, almost $600 million would come from regular sales tax, $163 million from meals tax and about $7 million from the interest float.[2] These figures are derived by a series of simulations using data that are not specific to Massachusetts. Many of the studies utilized in

[1] They cite a study performed by Performance Economics, LLC in 2019 entitled *Estimating the Costs and Benefits of an Accelerated Sales Tax Remittance System for Massachusetts*.

[2] PE study, page 27.

the simulations are more than a decade old and do not account for the legal or regulatory changes occurring since then. Others focus on cash transactions that have higher rates of fraud but are irrelevant to daily remittance.

At the same time, the PE study ignores the sizeable cost to vendors and card processors. In a separate report released by the State Tax Research Institute (STRI), the costs are estimated to be $1.2 billion in one-time expenses and $28 million in annual costs.[3] One of the reasons implementation costs are so high is that there is currently no way for credit card processors to determine what portion of a credit card sale is subject to tax. Assuming the technology exists to do this by 2024, it will cost money to acquire and implement the technology, train people on its usage and then ongoing work on the part of the payment processors, who will charge a fee for those services. Retailers will also have to be trained in the new processes and will be required to do more work while paying credit card processors for performing the work on their behalf. That cost will ultimately be borne by consumers in the form of higher prices.

The final portion of the estimated $770 million, about $7 million, according to the PE report, comes from the Commonwealth recapturing the float on the sales tax revenues. One could argue that at least some portion of this amount is remuneration that vendors receive for collecting the tax on behalf of the state. Currently, Massachusetts vendors may "hold" the money for up to 50 days and make interest on the float. In many other states, retailers are paid for serving in this trustee capacity. Should MA policymakers ask retailers to remit the money daily and forego the float, an argument could be made that they should be otherwise compensated for their services.

<u>Claims that MA tax revenue collection system is antiquated and enables fraud ignores recent tax law changes.</u>

According to the PE report, the primary benefit of adopting daily remittance is that it will reduce fraud. The PE report assumes fraud equates to about 16% of total sales tax revenue.[4]

Several recent developments make the prevalence of such fraud levels unlikely. Notable among them are recent federal and state requirements that credit card processors issue a 1099-K form to businesses and individuals receiving credit card payments over a certain threshold that taxing authorities can use to verify sales tax remittance levels are appropriate.[5] In addition, MassTaxConnect, a new web-based platform that enhances data collection and analytical abilities, was adopted by the MA DOR in 2015. The recent *Wayfair* decision requires remote sellers of a certain size to collect sales tax even if they have no physical presence in Massachusetts, reducing another potential avenue to manipulate sales data. These changes,

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[3] The State Tax Research Institute estimated that the cost to be $1.2 billion in its 2020 study entitled "*The Illusory Benefits of Accelerated Sales Tax Remittance*."

[4] PE study , pages 22-23

[5] On the federal level, the IRS began requiring in 2012 that credit card payment processors issue 1099-K showing credit card processes to all businesses and individuals for amounts in excess of -----. In 2017, Massachusetts required credit card processors to issue M 1099-K's for payments to businesses and individuals exceeding $600 per year.

coupled with increased electronic filings and big data analytics, greatly reduce the opportunity for fraud and most likely make the PE report numbers inflated.

The PE fraud percentage also contrasts greatly with the Washington State DOR sales tax compliance study published in 2018 that estimates total sales tax noncompliance to be about 0.9% of total tax liability. This number is more recent and much more reliable as it is based on actual state sales tax data. Using Washington's estimate, Massachusetts sales tax fraud would total approximately $45m per year. While this money is worth pursuing, the cost of daily remittance outweighs the benefit of doing so and alternative methods for capturing this revenue should be explored.

2. Daily remittance doesn't apply to cash sales

The daily remittance proposal is built on a credit card processing platform, and therefore does not capture cash sales, checks, gift cards or split transactions.[6] That means that it has no way of stopping the higher incidents of fraud that result from these transactions and that retailers will still have to remit sales tax at the end of the month for cash sales. Thus, the daily remittance requirement doesn't replace the current monthly remittance requirement, it adds additional compliance burdens on to businesses. The fact that costs outweigh the benefits of this proposal would garner it unworkable under ordinary circumstances, but it makes no sense at all to implement it now when many retailers, restauranteurs and hoteliers are reeling from the pandemic.

MTF Position on Daily Remittance

MTF does not support daily remittance for the reasons outlined above – the revenues are overstated, as is the prevalence of fraud it purports to address, particularly since it does not apply to cash sales. This is also a policy decision that should be determined by the legislature, not left up to the Department of Revenue, as the Governor suggests. Given that Massachusetts would be the first and only state in the nation with such a policy, the details are very important and should be spelled out in statute. For all of these reasons, MTF does not support daily remittance of sales tax.

Summary

In the current challenging fiscal environment, adopting prepayment is a reasonable policy choice, but daily remittance clearly is not. For the foregoing reasons MTF opposes daily remittance in favor of a more straightforward prepayment proposal like those adopted by other states.

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[6] PE report, page 23 "The adoption of ASTR and the altering of the payment processors' platforms will help eliminate fraud and delinquency on sales made with debit and credit cards, but associated fraud with cash transactions will not be captured."