98-1 Taxation of Vending Machine Sales

Summary

During legislative deliberations on the 1997-99 Biennial Budget Bill, a proposal was developed to eliminate the sales tax on food and beverage items sold through vending machines and replace it with an annual permit fee for each vending machine. Because of uncertainty over the fiscal effect of the proposal, the provision was not adopted and the budget included a directive for the Legislative Audit Bureau to evaluate the proposal adopted by both the Assembly Republican and Senate Democratic caucuses for its fiscal effect and feasibility, and for potential constitutional questions.

Under the proposal, operators of food and beverage vending machines would be charged $65 per machine for an annual permit, and operators of vending machines that charge no more than $0.25 per item (typically gum and nut machines) would pay $10 per machine annually. In those counties that levy a 0.5 percent local sales tax, an additional $1 would be added to the $65 permit fee and remitted to the county, but no increase would be made to the $10 fee for machines that sell items for no more than $0.25.

The proposal was advocated by the Wisconsin Automatic Merchandising Council, which claims to represent approximately 25 percent of the vending machine operators in the state and to account for approximately 15 percent of total vending machines and annual vending machine sales. The Council asserted that under the current sales tax, inequities are created because:

- some food and beverage items are subject to sales tax when sold through vending machines but are exempt in other cases;
- vending machine prices that reflect the sales tax will appear higher than over-the-counter prices that do not reflect sales tax; and
- enforcement difficulties allow some vending machine owners to avoid paying sales tax.

Members of the Automatic Merchandising Council would realize a significant tax reduction under the proposed permit fee system because proposed per machine fees are less than the average estimated sales tax currently due on sales from vending machines. Nevertheless, the Council argues that the proposed permit fee system could increase state revenues and, at minimum, would be revenue neutral for the State because enforcement would be simplified, compliance would be improved, and the increased number of businesses paying the fee would offset reductions in the amount currently paid by businesses that comply with the sales tax.

On the other hand, members of the Wisconsin Soft Drink Association, which represents soft drink bottlers, believe they would be financially harmed by a permit system. Currently, sales taxes on soft drinks sold through vending machines are paid by vending machine owners and operators. However, the bottlers believe that because of the competitive nature of the soft drink industry, the cost of machine permits would be shifted to soft drink wholesalers during their contract negotiations with retailers. They also argue that a shift to a permit fee would be a net revenue loss to the State.

The fiscal effect of the proposal is difficult to determine precisely: not only must current sales tax receipts and potential revenue from a permit system be estimated, the factors on which these revenue calculations are based are also estimates that cannot be fully verified. Because the Department of Revenue does not require businesses to specify in their sales tax reports whether sales were direct or through vending machines, current sales tax receipts must be estimated. This can be done by multiplying the number of machines in the state by the average sales volume per machine and by tax compliance rates. However, because no verifiable data are available for these three factors, they also must be estimated. Information provided by the Automatic Merchandising Council on the number of food and beverage vending machines

and their average sales volume suggests that the effect of the permit fee proposal on the State's General Fund would be revenue neutral; information on the number of machines and average sales volume provided by the Soft Drink Association suggests the proposal would result in a net revenue loss for the State.

We developed estimates of the number of food and beverage vending machines in Wisconsin from information supplied by two states that operate vending machine permit systems and two that have considered such a system. We adjusted information provided by these states to reflect differences in population and the greater degree of industrialization in Wisconsin. To estimate average sales per machine, we used information supplied by both the vending machine operators and the bottlers, as well as information from industry trade publications and from Wisconsin businesses, schools, and other entities in which vending machines are located. To estimate compliance under both the current sales tax and the proposed permit system, we used information from the Automatic Merchandising Council and the Department of Revenue.

Based on these new estimates of the number of machines in the state, their average sales volume, and compliance under both systems, we estimate the proposed permit system would generate between $4.1 and $5.6 million less annually than current sales taxes. This estimate includes the Department of Revenue's increased administrative costs to operate and enforce a permit system. In order to be revenue neutral for the State and to offset increased administrative costs, we estimate the proposed $65 permit fee would need to be increased to $123 per machine. However, if tax compliance in the industry exceeds the current estimate of 55 percent, or if compliance with a permit system were to be below the estimate of 95 percent, the State would experience a net revenue loss even with a fee of $123 per machine.

To implement a permit fee system, the Legislature would also need to address how the system would be administered and whether counties should be compensated for their loss of local sales tax revenue. Under the existing proposal, the Department of Revenue would administer the permit system but could contract with other parties, such as local governments, for selling and enforcing the permits. The proposal authorizes $8 of each $65 permit, and $2 of each $10 permit, to be used for such contracting. However, our survey of Wisconsin's larger municipalities indicated that few would voluntarily provide local program administration and enforcement for these amounts. If the State were to contract at a higher amount, the overall cost of the permit would need to be increased beyond $123 for the effect on the General Fund to be revenue neutral. Conversely, the Department of Revenue has recommended that for more uniform enforcement, it should be authorized all responsibility for administering the permit system, including selling permits and enforcing compliance. The Department has developed detailed fiscal estimates of some administrative costs, such as printing the permits and computer support, but it has not made detailed estimates of the potential costs of selling permits and enforcing compliance. Nevertheless, the Department believes its total administrative and enforcement costs would be no more than the proposed $8 per machine.

Even increased permit fees will result in future revenue losses if fee amounts are not adjusted to reflect increases in the price of goods sold through vending machines and increases in the volume of vending machine sales. The current sales tax, which is based on a percentage of sales, automatically makes these adjustments. This report includes a number of options to control the effects of inflation, which the Legislature could consider if it establishes a permit fee system.

Currently, 49 counties levy a local sales tax of 0.5 percent. Based on average sales per machine of $4,000, counties that levy the 0.5 percent county tax currently are due $20 in tax revenue per machine, but they would receive only $1 per machine under the permit fee proposal. If the Legislature chooses to make the proposal revenue neutral for counties, the $65 permit fee would need to be increased beyond $123 in those counties that levy the optional county sales tax.

As the permit fee proposal was being drafted, a question about its constitutionality was also raised. Analysis by staff of the Legislative Council suggests that a challenge could conceivably be made to a permit system on the grounds that it would violate the equal protection clauses of the federal and state constitutions. However, staff of the Legislative Council noted that tax laws typically carry a strong presumption of constitutionality and that courts have recognized that absolute equality in tax laws is impossible. Consequently, there does not appear to be a constitutional impediment to enacting a vending machine permit system. Based on the Legislative Council attorney's analysis, our report contains several suggestions the Legislature could consider to specify legislative intent, which would facilitate judicial review in the event of a court challenge.