

**DEPARTMENT OF TAXATION
2002 Fiscal Impact Statement**

1. Patron: Orrock

3. Committee: House Finance

4. Title: Retail Sales and Use Tax:
Food Tax Reduction Program -
Definition of Food Amended

2. Bill No: HB 86

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would amend the definition of "food" used in the Food Tax Reduction Program to exclude food sold by any retail establishment whose gross receipts derived from the sale of prepared food by such establishment for immediate consumption constitutes more than 80% of the total gross receipts of the establishment.

For purposes of applying the "80% rule," the calculation of total gross receipts would include motor fuel purchases as well as all other purchases made at the establishment. For purposes of this bill, "retail establishment" means each place of business for which any dealer is required to apply for and receive a sales and use tax certificate of registration.

The effective date of this bill is not specified.

6. Fiscal Impact Estimates are: Not Available. (See Line 8).

7. Budget amendment necessary: No.

8. Fiscal implications:

Administrative Impact

This bill would result in minimal administrative costs to the department. The department would notify dealers of the exclusion of certain retail establishments via the regularly scheduled forms mailing.

Revenue Impact

Under this bill, fast food establishments and restaurants would collect and remit the sales and use tax at the full rate of 4.5% on qualifying food for home consumption that is currently taxed at the reduced rate of 4%. This would generate a modest gain in revenues for fiscal years 2003 and 2004. The magnitude of the increase in revenues is unknown, as there is insufficient data available to generate a quality revenue estimate. The ½% rate reduction currently in effect is estimated to reduce state revenues by \$48.1 million in fiscal year 2003 and \$49.4 million in fiscal year 2004. As a result of this bill, the actual revenue loss would be reduced.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Amended Food Definition

Under the Food Tax Reduction Program, the reduced sales tax rate applies to “food” as defined in the federal Food Stamp Program. This definition includes most staple grocery food items and cold prepared foods packaged for home consumption. The reduced rate is applied to qualifying food items without regard to the nature of or type of retailer making sales of such food. Retailers that are sellers of food purchased for home consumption include bakery and pastry shops, cafeterias, convenience stores, department stores, fast food establishments, restaurants, grocery stores, mail order companies, supermarkets, specialty meat and produce markets, video stores, and weight reduction centers.

This bill would amend the definition of “food” used in the Food Tax Reduction Program to exclude fast food establishments and restaurants that derive more than 80% of their total gross receipts from the sale of food prepared for immediate consumption from imposing the reduced sales and use tax rate on sales of qualifying food. The calculation of total gross receipts to include motor fuel purchases ensures that establishments with high fuel sales, such as convenience stores, are not included in the exclusion.

Gross receipts information would be calculated for each retail establishment that is deemed a dealer and holds a sales and use tax certificate of registration with the Department of Taxation in accordance with Code of Virginia §§ 58.1-612 and 58.1-613.

House Finance Subcommittee Study

The 2001 Session of the General Assembly established a House Finance Subcommittee to develop a uniform definition of “food” for purposes of the Food Tax Reduction Program and local meals tax, and to develop a method for applying the definition consistently to all sellers of food. The Subcommittee consulted with industry representatives from the Food Dealers Association, Virginia Hospitality and Travel Association, Retail Merchants Association (Virginia and Greater Richmond), Petroleum Marketers & Convenience Store Association, Virginia Municipal League, and the Virginia Association of Counties. The Department of Taxation provided technical assistance. Discussions focused on the broad application of the federal Food Stamp Program definition of “food” and implementation issues regarding food retailers. This bill results from the Subcommittee’s review and input from the industry representatives.

Other States’ Food Exemptions

Generally

Of the 45 states that impose sales and use taxes, 30 currently provide an exemption of some type for food for home consumption. These exemptions range from full exemptions, some with phase-out provisions, to partial exemptions applying reduced rates on food. Some states fully tax food sales and allow an income tax credit or grant a refund for sales and use tax paid on food. The most recent additions are Louisiana, North Carolina and Virginia. Louisiana, however, has temporarily suspended its exemption. North Carolina and Virginia provide a reduced sales and use tax rate on food for home consumption. (Source: Survey by Federation of Tax Administrators.)

Beginning October 1, 1997, Missouri enacted a reduced sales tax rate (1.225%) on all types of food that may be purchased with food stamps under the federal Food Stamp Program. In 1999, Missouri amended its food definition to exclude food or drink sold by any establishment where the gross receipts derived from the sale of food prepared for immediate consumption constitutes more than 80% of the total gross receipts. The amendment to the Missouri statute is almost identical to the amendment proposed in this bill.

Border States

The border states that provide an exemption of some type for food are the District of Columbia, Kentucky, Maryland, and North Carolina. Each of these states limits the application of the exemption or reduced rate by retailer as follows:

- The District of Columbia provides an exemption for food for home consumption (except snack foods). Food and drink served by or sold in or by restaurants and like

places of business are considered food and drink prepared for immediate consumption and are taxable. The District of Columbia applies a 70% gross receipts rule in determining sellers of food for immediate consumption who are taxable.

- Kentucky provides an exemption for food for home consumption. Food sold by a retailer who ordinarily sells for consumption on or near the premises of the retailer, even when the food is sold on a “take out” or “to go” order, is taxable.
- Maryland provides an exemption for food for home consumption off the premises by a food vendor who operates a substantial grocery or market business at the same location where the food is sold. Restaurants are taxable on their sales of food.
- North Carolina provides a reduced sales tax rate on food for home consumption and follows the federal food stamp definition of “food.” Restaurants are not deemed sellers of food for home consumption and are taxable on their sales of food.

Tennessee and West Virginia currently impose the sales and use tax on food and food products.

Other Legislation

House Bill 1052 would repeal the current Food Tax Reduction Program and provide a total exemption for food purchased for home consumption, effective July 1, 2002.

Senate Bill 104 would delete the safeguards in the Food Tax Reduction Program and reduce the state sales tax on food purchased for home consumption to 1½%, effective April 1, 2003.

Senate Bill 189 would provide an exemption from the state sales and use tax on food purchased for home consumption.

cc: Secretary of Finance

Date: 1/15/02/VHM

Document: S:/2002leg/WorkInProgress/OTPWork/HouseBills/HB0086F161.DOC