

# EXECUTIVE SUMMARY:

## PARTIAL EXEMPTION FOR FOOD

(SALES TAX)

JULY, 2014

JOINT SUBCOMMITTEE TO EVALUATE TAX PREFERENCES

---

- PREFERENCE:

§ 58.1-611.1

---

- SUMMARY:

Provides for a 1.5 percent state sales and use tax rate for food, in lieu of the standard 4.3 percent state sales and use tax rate. With the local-option one percent sales and use tax rate, the effective rate of the tax on food is 2.5 percent.

---

- REVENUE IMPACT:

The partial sales tax exemption for food purchased for home consumption accounts for approximately \$526.7 million in reduced state and local tax revenue (Fiscal Year 2014).

---

- JOINT SUBCOMMITTEE RECOMMENDATION:

The Joint Subcommittee recommended continuing the partial sales and use tax exemption for food. However, interest was expressed in possibly phasing out the state portion of the sales and use tax on food in the future, as a part of a larger tax reform discussion, if revenues from other sources could be identified to hold transportation and education funding harmless.

---

# PREFERENCE REPORT: PARTIAL EXEMPTION FOR FOOD

(SALES TAX)

JULY, 2014  
JOINT SUBCOMMITTEE TO EVALUATE TAX PREFERENCES

## Preference Description

---

Section 58.1-611.1 of the Code of Virginia<sup>1</sup> provides for food to be taxed at a rate of 1.5 percent of the sales price, instead of the standard rate of 4.3 percent imposed on tangible personal property under the general state sales and use tax.<sup>2</sup> This 1.5 percent state tax is in addition to the local option one percent sales and use tax imposed by all localities in the Commonwealth to tangible personal property,<sup>3</sup> bringing the effective rate of tax on food to 2.5 percent. "Food," for purposes of the tax, generally include all foods for a household to eat or drink, but excludes alcohol, hot foods, and food intended to be eaten on-premises.

Section 58.1-611.1 also specifically specifies how the revenues collected from the 1.5 percent sales tax on food are to be distributed: the revenue collected from a tax equal to one-half percent is paid into the Transportation Trust Fund; the revenue collected from a tax equal to one percent is apportioned and paid to the localities to be used for expenses incurred in the operation of public schools.<sup>4</sup>

## Preference Purpose

---

No affirmative statement of purpose can be found in the statute itself or in the record accompanying the initial drafting request of the legislation. However, general policy analysis leads one to the conclusion that the rate of tax imposed on food was lowered because food is an essential item, and imposition of the sales and use tax on such a basic human necessity is inherently regressive, as lower income persons and families spend a greater portion of their income on food than higher income individuals. Therefore, lowering the tax on food serves to lessen this tax burden on this necessary purchase.

---

<sup>1</sup> See Appendix A for complete text of § 58.1-611.1.

<sup>2</sup> See §§ 58.1-603 and 58.1-604 of the Code of Virginia.

<sup>3</sup> See §§ 58.1-605 and 606 of the Code of Virginia.

<sup>4</sup> See § 58.1-611.1 (A) (2).

## Legislative History & Background

---

Until 1999, food was taxed at the same rate as other tangible personal property, and was not singled out or treated differently. In 1999, the General Assembly adopted a separate, lower rate of tax on food, which has been amended several times in the years since.

1999: The rate of tax on food was lowered from the standard 3.5 percent state sales and use tax in place at the time to a three percent state tax. The act also created a schedule by which the rate of tax on food would be lowered over a period of four years, to a final rate of 1.5 percent state tax to become effective on and after April 1, 2003. However, the scheduled phased-in reduction of the tax would be frozen if general fund revenues in the second fiscal year preceding the scheduled reduction did not exceed the official general fund revenue estimates for that year by at least one percent. The scheduled phase-in could also be frozen if certain revenue shortfalls or projections set forth in the Personal Property Tax Relief Act of 1998<sup>5</sup> (commonly referred to as "car tax relief") were triggered. The act defined "food purchased for human consumption" to have the same meaning as "food" as defined in the federal Food Stamp Act, except that the definition does not include seeds and plants that produce food. The act also established a special, nonreverting fund entitled the Food Tax Reserve Fund. Finally, the act clarified that local meals taxes did not apply to "food" as defined in the federal Food Stamp Act.<sup>6</sup>

2002: The General Assembly amended the definition of "food purchased for human consumption." While the definition was still tied to the federal Food Stamp Act, the amendments clarified that "food," for purposes of the tax preference, did not include food sold by a retail establishment where the sale of food prepared by the establishment for consumption on or off premises constitutes more than eighty percent of the total gross receipts of the establishment.<sup>7</sup>

2003: The General Assembly removed the language creating the Food Tax Reserve Fund. It appears that appropriations were never made to the Fund, and its intended use was not clear.<sup>8</sup>

2004: The General Assembly amended the timeline for the phased reduction of the food tax. As originally enacted in 1999, the tax would have completed its phased reduction by April 1, 2003. However, because of the revenue limitations placed on implementation of the reductions, the rate of state tax on food had been frozen at three percent -- the initial rate set in the 1999 legislation. The 2004 legislation removed all references to revenue caveats that would prevent the phased reduction from taking place. The legislation continued the rate of three percent through June 30, 2005, and then reduced the rate by half a percent each year over a period of three years to ultimately impose a 1.5% state tax on food beginning July 1, 2007.<sup>9</sup>

---

<sup>5</sup> See Chapter 35.1 (§ 58.1-3523 et seq.) of Title 58.1 of the Code of Virginia, as set forth in Chapter 2 of the Acts of Assembly of 1998, Special Session I.

<sup>6</sup> Chapters 366 and 466 of the Acts of Assembly of 1999.

<sup>7</sup> Chapter 13 of the Acts of Assembly of 2002.

<sup>8</sup> Chapter 806 of the Acts of Assembly of 2003.

<sup>9</sup> Chapter 3 of the Acts of Assembly of 2004, Special Session I.

2005: The General Assembly eliminated the phased reduction, and set the rate of state tax at 1.5% effective, July 1, 2005.<sup>10</sup>

## Revenue Impact

The partial sales tax exemption for food purchased for home consumption accounts for approximately \$526.7 million in reduced state and local tax revenue (Fiscal Year 2014).<sup>11</sup>

<b>Pretax Income</b>	<b>FY 2014 Reduced Tax Liability (in millions)</b>
Less than \$15,000	\$ 29.1
\$15,000 to \$19,999	15.7
\$20,000 to \$29,999	30.4
\$30,000 to \$39,999	34.5
\$40,000 to \$49,999	36.5
\$50,000 to \$69,999	73.0
\$70,000 and more	<u>307.4</u>
<b>Total</b>	<b>\$ <u>526.7</u></b>

A disproportionate share of the tax savings benefits high-income households. An estimated \$307.4 million in reduced tax liability goes to households earning \$70,000 or more based on an analysis of U.S. Census data and Consumer Expenditure Survey data. This income class represents 45% of Virginia households but receives 58% of the reduction in tax liability.<sup>12</sup>

However, lower income households also benefit significantly from the partial exemption because a greater share of their incomes is spent on basic necessities. Nationally, households earning less than \$15,000 per year spend an average of 30.7% of their pretax incomes on food for home consumption, and households earning at least \$15,000 but less than \$20,000 devote 15.8% of their pretax incomes to food at home. Across all households nationwide, the average is 6%.<sup>13</sup>

The purchase of food for home consumption is shrinking as a share of the overall economy. In 1973, food at home accounted for 14% of household expenditures. By 2012, that share had declined to less

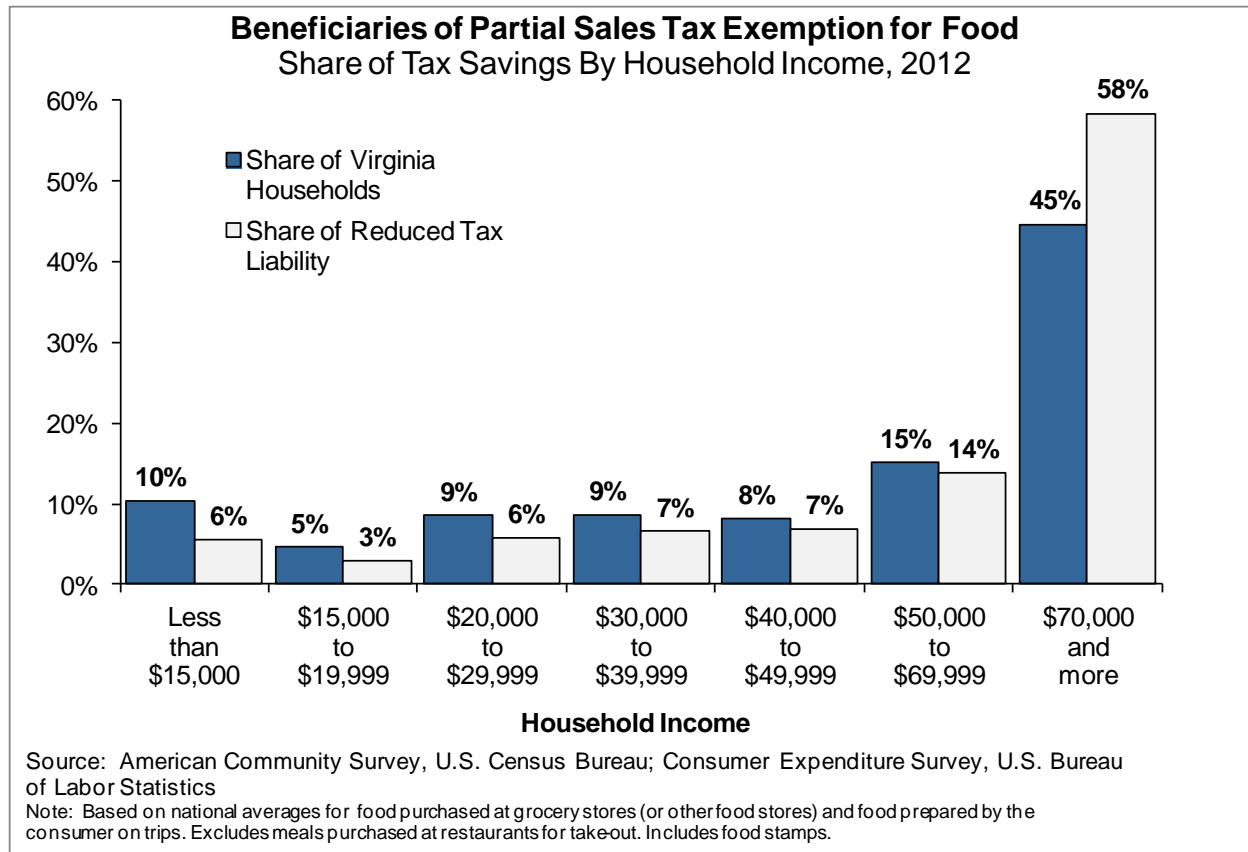
<sup>10</sup> Chapters 487 and 521 of the Acts of Assembly of 2005.

<sup>11</sup> Virginia Department of Taxation. The revenue impact is the difference between the revenue estimate at 2.5% versus a statewide effective rate of 5.65%.

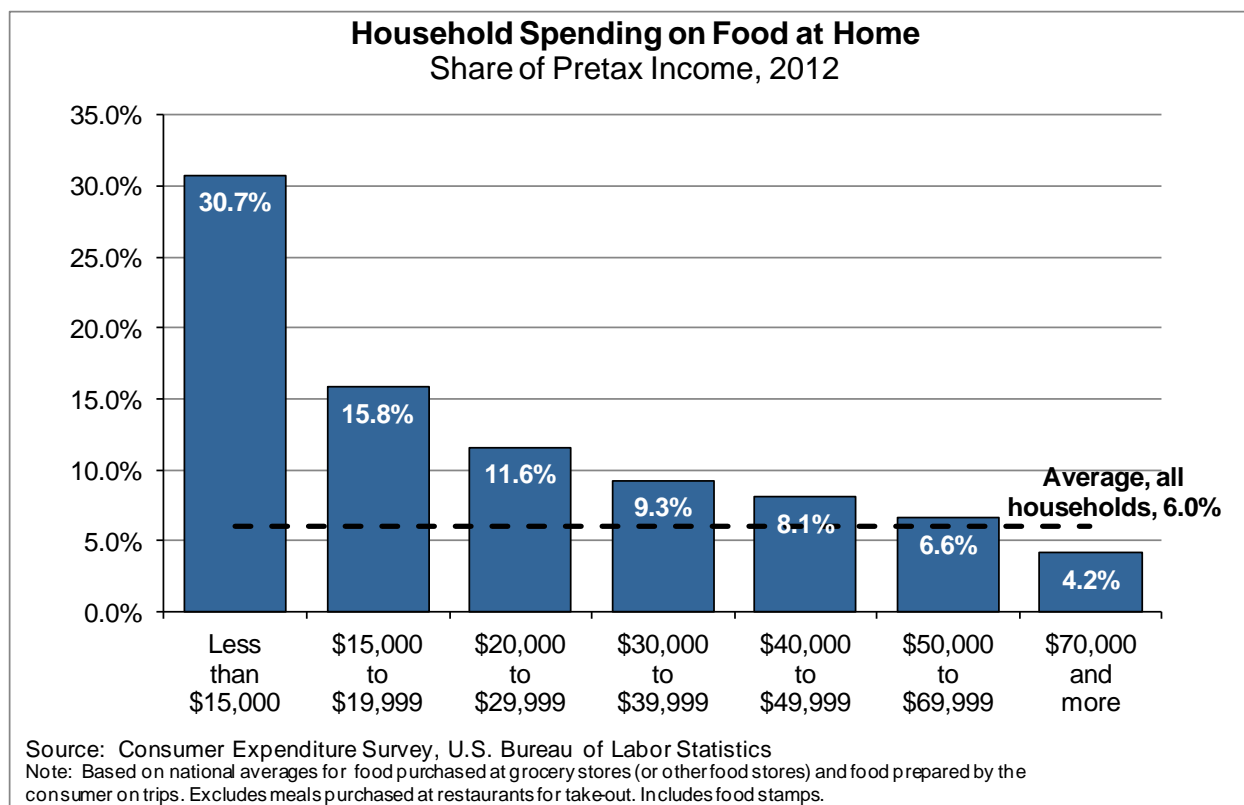
<sup>12</sup> U.S. Census Bureau, 2012 ACS 1-Year PUMS Files; U.S. Bureau of Labor Statistics, 2012 Consumer Expenditure Survey, Table 1202.

<sup>13</sup> U.S. Bureau of Labor Statistics, 2012 Consumer Expenditure Survey, Table 1202. Not adjusted for food stamps and/or WIC.

than 8%.<sup>14</sup> Consequently, the exemption's impact relative to other potentially taxable goods and services is declining over time.



<sup>14</sup> U.S. Bureau of Labor Statistics, 1972-1973 Consumer Expenditure Survey, Table 1; and, 2012 Consumer Expenditure Survey, Table 1202.



## Other States

Of the 46 states that impose a state sales and use or similar tax, 33 states exempt food from the tax, with some exceptions or limitations. Thirteen states --including Virginia -- impose a tax on food.<sup>15</sup> Six of those 13 states -- including Virginia -- impose the tax at a reduced rate, with the applicable rate ranging from 1 percent to 5 percent .<sup>16</sup> The other 33 generally exempt food from the tax, with some exceptions or limitations.<sup>17</sup>

Kansas has a unique approach to the food tax. Kansas applies its state sales and use tax to food at its standard rate of 6.3%. Until 2012, individuals who met certain criteria were eligible to receive a refund of any food tax paid. Beginning January 1, 2013, the refund was repealed, and a tax credit was put in its place. A taxpayer is eligible to claim a nonrefundable credit on his state income tax return if he has purchased food in Kansas, has federal adjusted gross income that does not exceed \$30,615, is domiciled in Kansas, and (i) has a disability, (ii) is 55 years or age or older, or (iii) claims an exemption for one or

<sup>15</sup> Alabama, Arkansas, Hawaii, Idaho, Illinois, Kansas, Mississippi, Missouri, Oklahoma, South Dakota, Tennessee, Utah, and Virginia.

<sup>16</sup> Arkansas, Illinois, Missouri, Tennessee, Utah, and Virginia.

<sup>17</sup> For example, food is exempt from the state sales and use tax in North Carolina, but is still subject to local taxation.

more dependent children under 18 years of age. The amount of the credit is equal to \$125 for every exemption claimed.<sup>18</sup>

## Other Information

---

It is important to distinguish the state sales tax on food from two separate, but related tax provisions. The lowered tax rate for food does not apply to prepared food purchased in a restaurant. Such food would be subject to the regular rate of state and local sales tax, plus any additional food and beverage tax (commonly referred to as the meals tax) authorized by the locality.<sup>19</sup> In addition, food sold in a vending machine is not subject to the lowered food tax rate. Dealers that sell tangible items (including food or beverage) must submit an amount equal to 5.3 percent of the vending sales.<sup>20</sup>

## Joint Subcommittee Recommendation

---

The Joint Subcommittee recommended continuing the partial state sales and use tax exemption on food. However, interest was expressed in possibly phasing out the state portion of the sales and use tax on food in the future, as a part of a larger tax reform discussion, if revenues from other sources could be identified to hold transportation and education funding harmless.

Preference Report Compiled by Staff from the  
Virginia Division of Legislative Services and the  
Virginia Department of Taxation

---

<sup>18</sup> See Kan. Stat. Ann. § 79-32,270.

<sup>19</sup> See § 15.2-1104 as it relates to the power of cities and towns to impose taxes; see § 58.1-3833 as it relates to the power of counties to impose a food and beverage tax.

<sup>20</sup> §58.1-614.

§ 58.1-611.1. Rate of tax on sales of food purchased for human consumption.

A. The tax imposed by §§ 58.1-603 and 58.1-604 on food purchased for human consumption shall be levied and distributed as follows:

1. From January 1, 2000, through midnight on June 30, 2005, the tax rate on such food shall be three percent of the gross sales price. The revenue from the tax shall be distributed as follows: (i) the revenue from the tax at the rate of one-half percent shall be distributed as provided in subsection A of § 58.1-638, (ii) the revenue from the tax at the rate of one percent shall be distributed as provided in subsections B, C and D of § 58.1-638, and (iii) the revenue from the tax at the rate of one and one-half percent shall be used for general fund purposes.

2. On and after July 1, 2005, the tax rate on such food shall be one and one-half percent of the gross sales price. The revenue from the tax shall be distributed as follows: (i) the revenue from the tax at the rate of one-half percent shall be distributed as provided in subsection A of § 58.1-638 and (ii) the revenue from the tax at the rate of one percent shall be distributed as provided in subsections B, C and D of § 58.1-638.

B. The provisions of this section shall not affect the imposition of tax on food purchased for human consumption pursuant to §§ 58.1-605 and 58.1-606.

C. As used in this section, "food purchased for human consumption" has the same meaning as "food" defined in the Food Stamp Act of 1977, 7 U.S.C. § 2012, as amended, and federal regulations adopted pursuant to that Act, except it shall not include seeds and plants which produce food for human consumption. For the purpose of this section, "food purchased for human consumption" shall not include food sold by any retail establishment where the gross receipts derived from the sale of food prepared by such retail establishment for immediate consumption on or off the premises of the retail establishment constitutes more than 80 percent of the total gross receipts of that retail establishment, including but not limited to motor fuel purchases, regardless of whether such prepared food is consumed on the premises of that retail establishment. For purposes of this section, "retail establishment" means each place of business for which any "dealer," as defined in § 58.1-612, is required to apply for and receive a certificate of registration pursuant to § 58.1-613.