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February 5, 2024

House Committee on Finance
Subcommittee #3
Virginia General Assembly

Via E-Mail

Re: H.B. 889 – Sales and Use Tax Base Expansion

Dear Chair Sullivan and Members of the Committee:

As drafted, H.B. 889 would expand the State’s sales tax base to many services, including “digital personal property,” a newly defined term. COST does not generally oppose legislation that expands the sales tax base to business-to-consumer transactions. However, we do oppose legislation that expands the sales tax base to business-to-business transactions since a fair, efficient and well-designed sales and use tax should be on final consumption. Approximately 40% of Virginia’s current sales tax base consists of business inputs, and taxing more business inputs would increase that share. Furthermore, we encourage the use of terms as defined in the Streamlined Sales and Use Tax Agreement as they have been fully vetted and are used in many states.

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of over 500 major corporations engaged in interstate and international business, many of which directly conduct business in Virginia. COST’s objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

COST Opposes Sales Tax on Business Inputs

The COST Board of Directors has adopted a formal policy position opposing the imposition of state taxation on business inputs.¹ That policy position provides:

Imposing sales taxes on business inputs violates several tax policy principles and causes significant economic distortions. Taxing business inputs raises production costs and places businesses within a State at a competitive disadvantage to businesses not burdened by such taxes. Taxes on business inputs, including taxes on services purchased by businesses, must be avoided.

¹ See <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/fy15-state-and-local-business-tax-burden-study.pdf>.

Imposing sales tax on business inputs specifically violates the tax policy principles of neutrality, equity, simplicity, and transparency, and it causes a number of economic distortions. These distortions result primarily from pyramiding, which occurs when a tax is imposed at multiple levels and results in a hidden effective tax rate that exceeds the retail sales tax rate. Pyramiding forces companies to either pass these increased costs to consumers or reduce their economic activity in the State to remain competitive with other producers who do not bear the burden of such increased taxes. Because of these choices, the economic burden of taxes on business inputs inevitably shifts to labor in the State (through lower wages and employment) or consumers (through higher prices).

H.B. 889 Negatively Expands Virginia’s Sales Tax on Business Inputs

Sound tax policy dictates that an optimal sales tax system should only tax end-user consumption and exempt business inputs such as manufacturing equipment. While most states exempt manufacturing equipment to avoid sales tax pyramiding, as states expand their sales tax base to the digital economy they should implement a broad exemption for digital business inputs. The best time to exempt business-to-business purchases of digital products is at the same time the state expands its sales tax base to include business-to-consumer purchases of digital products.² Doing otherwise would harm the State by discouraging increased business activity (investment and jobs). Currently, Virginia derives approximately 40% of its sales tax revenue from the taxation of business inputs;³ the bill as drafted would increase this percentage.

Virginia Should Use Common Terminology

Instead of adopting new terminology like “digital personal property,” we encourage Virginia to use terminology as defined in the Streamlined Sales and Use Tax Agreement as that terminology has been fully vetted and used by other states and the business community.

Conclusion

COST opposes the increase in the State’s sales tax base to business inputs. Instead, the Legislature should include an exemption for business purchases of digital products newly added to the sales tax base. In addition, the State should consider using terms that are already vetted and used by other states and the business community. Please let us know if we can provide additional assistance.

Respectfully,



Patrick J. Reynolds

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director

² See Karl A. Frieden and Fredrick J. Nicely, “Digital Business Input Exemptions: Lessons from Sales Tax History,” *Tax Notes State*, January 29, 2024, especially Part 6.

³ COST “Best and Worst Sales Tax Systems Scorecard” is available at https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/270677_cost_salestaxbk_2022_final.pdf