

Minnesota Consumption Tax Model and Sales Tax Gap

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**By
Rod Hoheisel
Minnesota Department of Revenue
rod.hoheisel@state.mn.us**

Minnesota Sales and Use Tax Gap Report

- Updates Previous Study
- New Study
 - Contract for work and updated model.
 - DOR had working role for part of the study.
 - Base year estimates for 2004, projections to 2011.

Basic Questions Addressed in the Report

- What is the estimated amount of sales and use tax gap?
- How rapidly will the tax gap grow?
- How much of the tax gap results from underpayment by current filers compared to non-filers?
- What industries are most likely to underpay tax?
- How does underpayment of use tax compare to underpayment of sales tax?
- How much of the unpaid total is attributable to remote sales?

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Department of Revenue Role

- Goal was to make it possible for Tax Research/DOR to produce future updates.
- DOR prepared:
 - 1) taxpayer transaction files,
 - 2) audit data files (used for imputations to unaudited taxpayers by industry).

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Gap Estimates are Based on Consumption Tax Model

- Consumption Tax Model provides estimates of sales and use tax collections under “full compliance” scenario.
- Full compliance – actual pre-audit collections = tax gap

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Consumption Tax Model Calculations

- Based on I-O and other U.S. data (scaled to MN) that detail purchases by industry/commodity.
- Estimates portion of these purchases assumed to be taxable.
- Includes estimates of sales and use tax payments for:
 - 1) consumers on their purchases,
 - 2) businesses on intermediate good purchases, and
 - 3) businesses on capital purchases.

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Consumption Tax Model Improvements

- More current BEA information is now available, e.g., Annual I-O Data.
- More categories of personal consumption expenditures (PCE) are available.
- State estimates of PCE amounts are more precise by using Census of Retail Trade and Services MN/US ratios.

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Chart 1
Taxpayer Files and Consumption Tax Model Steps

Source	Measure
(i) Consumption Tax Model: Estimate of All Transactions Subject to Tax	Full Compliance Estimate
(ii) Sales and Use Tax Return Transaction Files	Actual Pre-Audit Collections
(iii) Difference of (i) – (ii)	Total Sales and Use Tax Gap
(iv) Audit Data Imputed to All Filers by Industry to Estimate Underpayments	Filer Sales and Use Tax Gap
(v) Difference of (iii) – (iv)	Non-Filer Tax Gap

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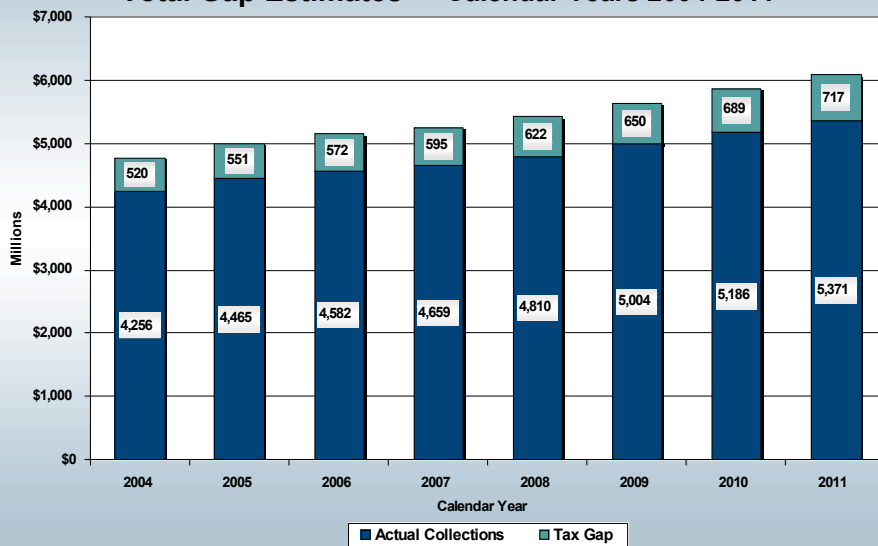
Chart 2
Estimated Sales and Use Tax Gap by Year (\$
Millions)

Calendar Year	Potential Collections	Actual Pre-Audit Collections	Gap*	Gap as Percent of Actual Collections
2004	\$4,776	\$4,256	\$520	12.2%
2005	5,016	4,465	551	12.3%
2006	5,154	4,582	572	12.5%
2007	5,254	4,659	595	12.8%
2008	5,433	4,810	622	12.9%
2009	5,653	5,004	650	13.0%
2010	5,875	5,186	689	13.3%
2011	6,088	5,371	717	13.4%

*Does not include the sales tax on motor vehicles.

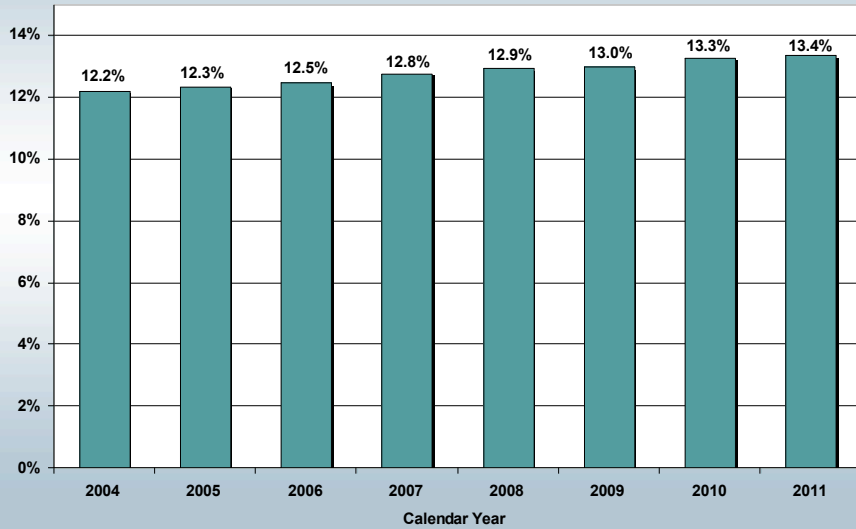
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Chart 3
Total Gap Estimates - Calendar Years 2004-2011



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Chart 4
Total Tax Gap as Percent of Actual Collections
Calendar Years 2004-2011



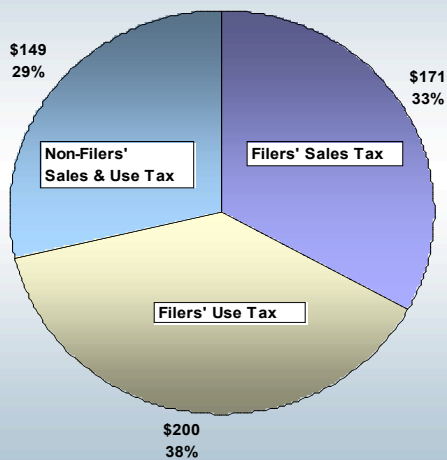
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Chart 5
Filer and Non-Filer Gap in 2004
Percent of

Portion of Gap	Dollars (Millions)	Percent of Actual Collections
Filer Gap		
Use Tax	\$200	68.9%
Sales Tax	171	4.3%
Total	\$371	8.7%
Non-Filer Gap	\$149	n/a
Total Gap	\$520	12.2%

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Chart 6
Sales and Use Tax Gap (2004)
 (\$ Millions)



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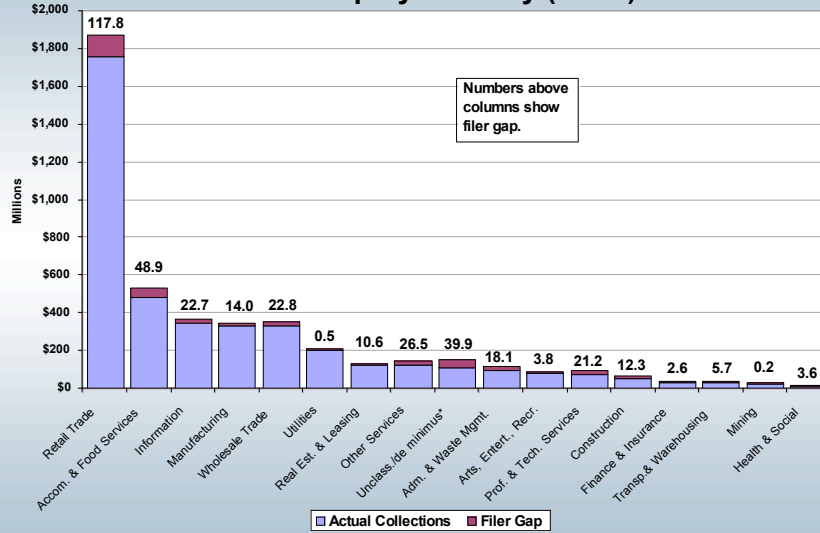
Chart 7
Filer Gap by Industry in 2004 (\$ Millions)

Industry	NAIC Ranges	Collections	Filer Gap
Retail Trade	441000 – 454390	\$1,755.1	\$117.8
Accommodation & Food Services	720000 – 722410	484.9	48.9
Information	510000 – 519190	348.5	22.7
Manufacturing	311000 – 339999	336.8	14.0
Wholesale Trade	420000 – 425120	333.8	22.8
Utilities	220000 – 221330	209.2	0.5
Real Estate & Leasing	530000 – 533110	127.0	10.6
Other Services	810000 – 928120	123.8	26.5
Unclassified and de minimus*	110000 – 115310 550000 – 551114 610000 – 611710 & Unclassified	102.7	39.9
Adm. & Waste Management	560000 – 562998	100.1	18.1
Arts, Entertainment, & Recreation	710000 – 713990	85.9	3.8
Prof. & Tech. Services	540000 – 541990	79.2	21.2
Construction	236000 – 238990	55.6	12.3
Finance & Insurance	520000 – 525990	36.6	2.6
Transp. & Warehousing	481000 – 493190	32.9	5.7
Mining	210000 – 213115	30.5	0.2
Health & Social	620000 – 624410	13.4	3.6
Totals		\$4,256.0	\$371.1

*Businesses without industry classification represent the vast majority of these dollars. *De minimus* industries include: Forestry, Fishing, Hunting, and Agriculture Support; Management of Companies and Enterprises; and Educational Services.

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Chart 8
Filer Gap by Industry (2004)



*Businesses w/out industry classification represent the vast majority of these dollars. *De minimus* industries include: Forestry, Fishing, Hunting, and Agriculture Support; Management of Companies and Enterprises; and Educational Services.

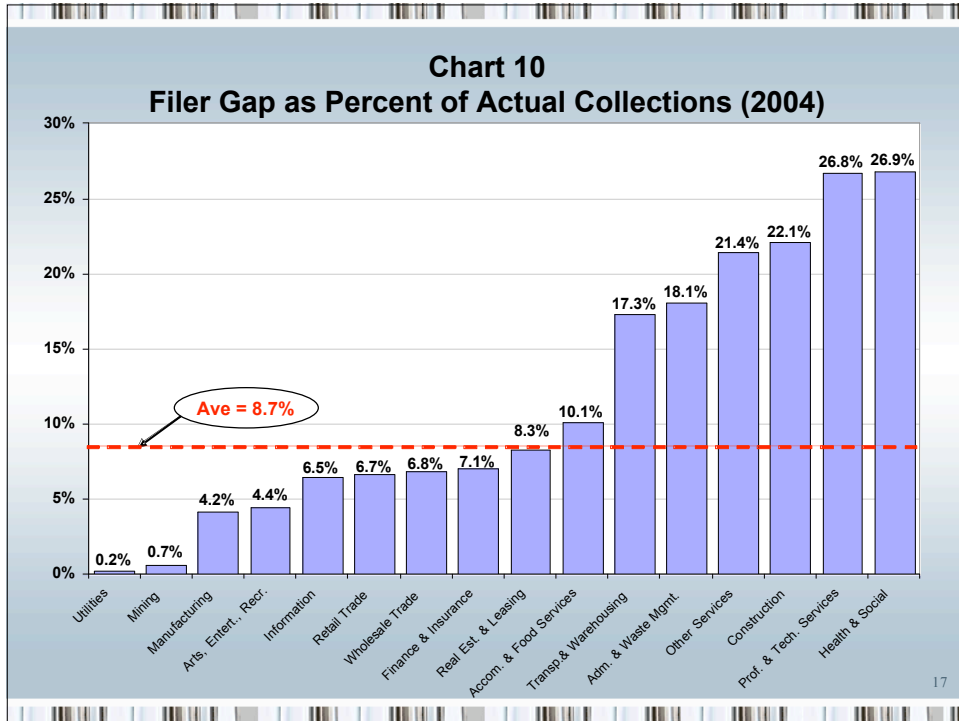
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Chart 9
Filer Gap as Percent of Collections by Industry (\$ Millions)

Category	Collections	Percent of Collections
ALL FILERS	\$4,256.0	8.7%
Utilities	209.2	0.2%
Mining	30.5	0.7%
Manufacturing	336.8	4.2%
Arts, Entertainment, & Recreation	85.9	4.4%
Information	348.5	6.5%
Retail Trade	1,755.1	6.7%
Wholesale Trade	333.8	6.8%
Finance & Insurance	36.6	7.1%
Real Estate & Leasing	127.0	8.3%
Accommodation & Food Services	484.9	10.1%
Transportation & Warehousing	32.9	17.3%
Administration & Waste Management	100.1	18.1%
Other Services	123.8	21.4%
Construction	55.6	22.1%
Professional & Technical Services	79.2	26.8%
Health & Social	13.4	26.9%
Unclassified & De minimus*	102.7	38.9%

*Businesses w/out industry classification represent the vast majority of these dollars. *De minimus* industries include: Forestry, Fishing, Hunting, and Agriculture Support; Management of Companies and Enterprises; and Educational Services.

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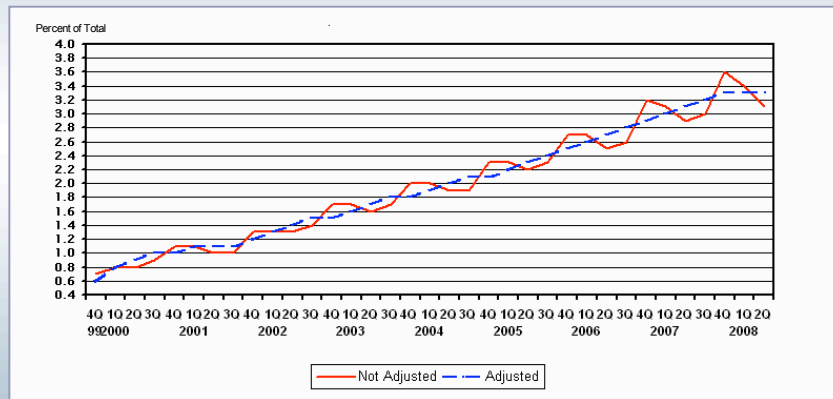
Growing Importance of Remote Sales

- ❑ **B2B Electronic Sales for 2005**
 - 26.7% of Manufacturer sales.
 - 18.3% of Wholesaler sales.

- ❑ **B2C Electronic Retail Sales**
 - 3.1% of All Retail Sales (2nd Quarter, 2008)
 - Rapid growth in recent years.

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Chart 11
Estimated Quarterly U.S. Retail E-Commerce Sales
as a Percent of Total Quarterly Retail Sales:
4th Quarter 1999–2nd Quarter 2008



Mail Order (Catalog) Sales

- Adds 2.5% to 3.1% electronic retail sales.
- Remote retail sales (e-commerce plus mail order) are 5.6% of total retail sales.

Electronic Sales - Services

- 1.6% of selected services* sales
- Most are B2C

*Including travel arrangement and reservation services, information services, and financial services.

Estimated Total Remote Sales and Use Tax Gap

Step 1: Retail Remote Sales Tax Gap

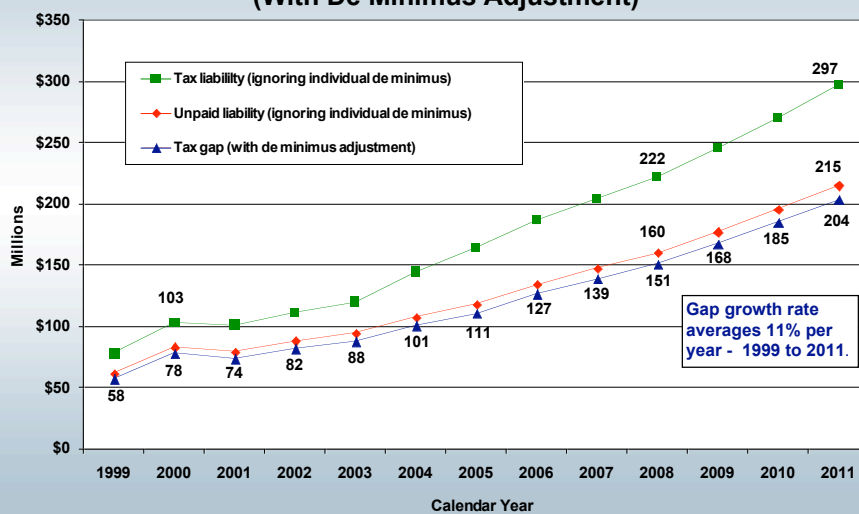
- Retail E-Commerce
- Mail Order Sales
- E-Commerce Sales of Services

Includes Adjustments for:

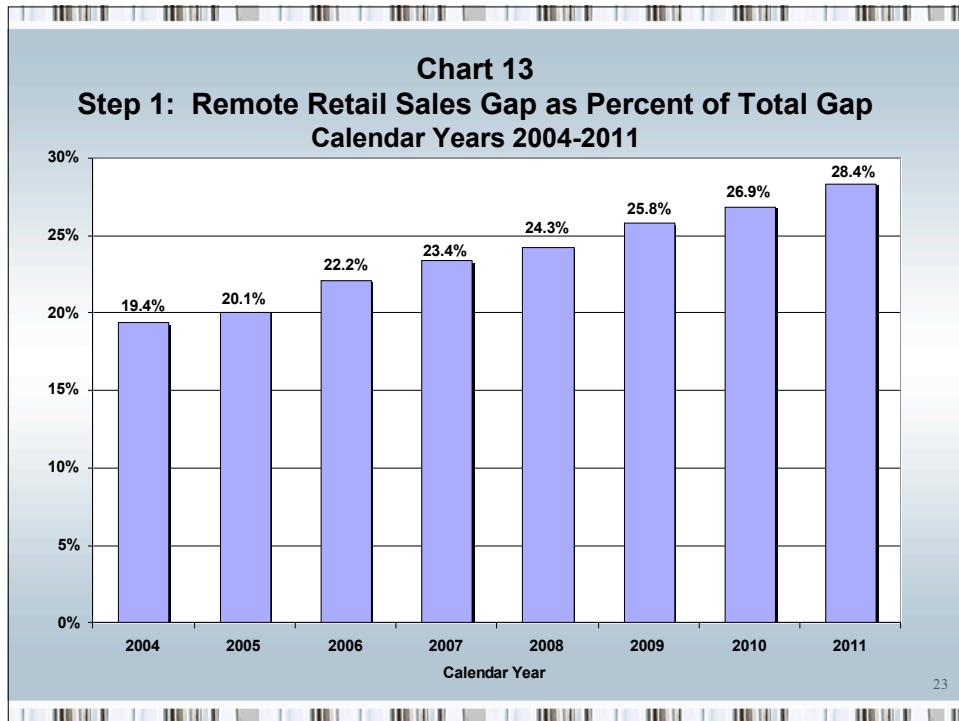
- Collections from NAICS 4541, electronic shopping and mail order houses. (Retail)
- Minnesota's de minimus use tax exemption for individuals. (Less than \$50 tax per year.)

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Chart 12
Step 1: Remote Retail Sales Tax Gap
(With De Minimus Adjustment)



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Estimated Total Remote Sales and Use Tax Gap (cont.)

Step 2: Calculated Share of Filer Use Tax Gap Due to Remote Sales

- Includes remote purchases by businesses directly from manufacturers and wholesalers.
- Estimated 80% of Filer Use Tax Gap.

Step 3: Other Adjustments

- E.g., eliminate overlap for portion of retail remote purchased by businesses.

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