

VERMONT DEPARTMENT OF TAXES

SMALL BUSINESS TAXPAYER OUTREACH AND EDUCATION WORKING GROUP REPORT

Act 73 of 2017, Sec. 24a. SMALL BUSINESS TAXPAYER OUTREACH AND EDUCATION WORKING GROUP

The Taxpayer Advocate at the Department of Taxes shall convene a working group of interested stakeholders to examine the ways the Department can improve outreach and education to small business taxpayers. On or before November 15, 2017, the Taxpayer Advocate shall report to the House Committee on Ways and Means and the Senate Committee on Finance recommendations to improve the relationship between the Department and small businesses. In considering the recommendations, the Taxpayer Advocate shall examine the following:

- (1) identifying complex areas of the law that could be simplified to enhance voluntary compliance;
- (2) compiling a list of common issues on which the Department may focus its outreach and education efforts;
- (3) considering how the Department can maximize its existing resources to provide additional guidance targeted to small businesses;
- (4) directing the Department to identify existing organizations and resources for small businesses and how to provide tax guidance through those organizations;
- (5) providing for a plan to contact and provide direction to new small businesses in Vermont within one year of their operation in the State;
- (6) recommending guidelines to forgive tax penalties and interest under certain circumstances; and
- (7) making other recommendations as appropriate.

SMALL BUSINESS TAXPAYER OUTREACH AND EDUCATION WORKING GROUP

SUBMITTED TO

House Committee on Ways and Means
Senate Committee on Finance

SUBMITTED BY

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DATE SUBMITTED

November 15, 2017

Contents

PROCESS	1
DISCUSSION	3
Areas of the Law that Could be Simplified	
Common Issues for Outreach and Education	
Maximizing Existing Resources for Outreach and Education	
Existing Organizations that Can Provide Guidance	
Plan to Contact Businesses in First Year of Operation	
Guidelines to Forgive Tax, Penalty, and Interest	
RECOMMENDATIONS	8
APPENDIX A	10

PROCESS

While discussing the composition of the Working Group, the Department determined that, regardless of the composition of the membership of the group, not all perspectives could be represented because small businesses are such a diverse class of taxpayer. For this reason, the Department organized a Small Business Listening Tour that would allow any interested businesses, business groups, tax preparers, or legislators to come and offer their opinions, criticism, or recommendations to the Department. The Small Business Listening Tour consisted of five meetings throughout the state. The meetings were held in St. Johnsbury, Montpelier, Burlington, Rutland, and Bennington. During the course of the Listening Tour, we estimate that we heard from approximately 50 Vermonters.

The Taxpayer Advocate, Commissioner of Taxes, Director of Policy, Outreach, and Legislative Affairs, and Executive Assistant to the Commissioner were present at the five meetings. Small business owners, representatives from Chambers of Commerce and small business advocacy groups, tax preparers, and legislators attended the meetings.

Some of the feedback received by the representatives of the Department included:

- Businesses think that the Department’s auditors are paid on commission, even though that is not true
- Businesses are frustrated over the current administration of Land Gains Tax and Real Estate Withholding, specifically the process and length of time for receiving a Commissioner’s Certificate for Real Estate Withholding
- The Department should create and advertise an Offer in Compromise program
- The Department should clarify what constitutes good faith when a vendor is accepting an exemption certificate from a customer
- The Department should clarify the obligations of the buyer and seller when a business is being sold
- The Taxpayer Advocate position needs to be better publicized
- Audits should be independently reviewed
- The Department should publish “hot topics” on website and highlight resources it has on those issues
- Members of the business community should review the Department’s forms and other publications before they are finalized
- A 2015 statutory change to the Current Use law made it extremely difficult to determine property valuation in situations where solar arrays were being added to property
- There should be more frequent filing options for Sales and Use, Meals and Rooms, and Withholding Taxes.
- Meals and Rooms Tax is too complicated to program into most point-of-sale systems
- The change in policy around cloud software from being taxable to nontaxable was confusing and costly for the industry
- The Department should provide more guidance regarding the consequences of hiring the first employee
- The Department’s automated phone system is frustrating. The options are not clear and there is no indication of when a taxpayer should expect a return call when leaving a voicemail. The Department should provide an automated acknowledgment of calls and an expected timeframe for a return call.
- Vendors should be able to retain a small percentage of the Sales and Use or Meals and Rooms Tax they collect, as compensation for collecting tax on behalf of the state. This would allow for businesses to invest in point-of-sale software to ease in the accurate collection of trust taxes.
- The Department should provide regular tax training to new businesses
- The Department should add a Small Business Guide to its website

The Working Group was pleased to learn that a few of these items are either in progress, or currently available to businesses. The desire for an Offer in Compromise program is something that the Department has heard from both taxpayers and the General Assembly. The General Assembly gave authority for the Department to conduct an Offer in Compromise program in 2011. As of the publication of this report, the Department is finalizing the program. Forms and other information about how to apply for an Offer in Compromise will be available on the Department's website.

Another frequently mentioned item was a Small Business Guide on the Department's website. Such a guide used to exist as a printed booklet, but it quickly would be out of date if the law changed around the topics in the booklet. The Department has published much of the same information in the form of fact sheets on the website, but business owners and members of the Working Group felt that those were hard for people to find. As a compromise, the Department's outreach staff is working on an Online Business Center that will compile the information in a way that makes it easier for businesses to find what they need.

Lastly, one business owner asked if she can remit her sales tax more frequently than monthly. While the Department is not statutorily allowed to require more frequent payment, the online portal, myVTax, is set up to accept more frequent payments. The Department should publish clear instructions that lets business owners know they can pay as frequently as they would like.

The Working Group discussed and expanded upon the feedback from the listening tour. Following the first meeting of the working group, the Taxpayer Advocate created an initial draft of this report. The Working Group convened a second meeting via teleconference to discuss the report, suggest any changes, and offer any additional suggestions or feedback that was not discussed in the first meeting of the working group. A final draft of the report was created based on the feedback presented in the second meeting.

AREAS OF THE LAW THAT COULD BE SIMPLIFIED TO ENHANCE VOLUNTARY COMPLIANCE

Sales and Use Tax and Meals and Rooms Tax were identified as areas that are extremely complex and confusing to small businesses. These areas of the law could benefit from simplification.

Due to the large number of exemptions for Sales and Use Tax, it is difficult to determine what is taxable and what is exempt. Attendees specifically highlighted use-based exemptions such as the agricultural and manufacturing exemptions as difficult to administer because the same product might be taxable to one customer but exempt to another. Also, these exemptions are often worded in a way that does not always reflect or apply to current and changing business models, leaving small businesses to make judgment calls on specific transactions. At this time, neither the group nor the Department recommend that any specific exemptions be eliminated or changed, though both suggest that the legislature consider the existing complexity in Sales and Use Tax and Meals and Rooms Tax when considering new exemptions to those statutes. The Administration will be considering options to put forward in January.

Similarly, concerns were raised regarding Meals and Rooms Tax. These concerns were predominately directed at the Meals Tax, which affects more small businesses than does Rooms Tax. Stakeholders and small businesses alike considered the distinction between a “meal” and a “grocery item” confusing and hard for small businesses to determine. One example from a local business during the Listening Tour included a bag of potato chips, which is subject to meals tax when sold by a restaurant but not subject to tax when sold by a convenience or grocery store. The Department is currently drafting a fact sheet describing “the life of a bag of potato chips” to illustrate this complexity. Another example mentioned were single serve bakery items which are not subject to tax when sold in quantities of three or more but are subject to tax when sold in quantities of one or two.

Non-profits present another example of complexity in Meals Tax. Unlike Sales and Use Tax, which determines taxability based on the type of entity, taxability under Meals Tax is determined based on a combination of the type of entity, where the meal is being served, and what the purpose is of the event where the meal is being served. Most small businesses do not have the information required to determine that a given event meets all the criteria for a meal to not be taxable under the nonprofit exemption in Meals Tax. Since the Listening Tour concluded, the Department’s outreach staff completed guidance on its website to nonprofits. This is currently being distributed to the business and nonprofit communities to increase clarity and knowledge regarding nonprofits. The Deputy Commissioner also recently presented to a group of nonprofits about Sales and Use and Meals and Rooms Taxes.

COMMON ISSUES ON WHICH THE DEPARTMENT CAN FOCUS OUTREACH AND EDUCATION EFFORTS

The Group identified the following as major issues on which the Department can focus its outreach efforts:

1) Sales and Use Tax

A. Clothing vs. Safety Equipment

Items defined as clothing are exempt from Sales and Use Tax but items defined as safety equipment are subject to Sales and Use Tax. Small businesses selling these items can get confused as to whether an item is clothing or safety equipment. An example of this confusion specifically presented during the Listening Tour includes winter gloves being exempt while work gloves are taxable. The Department has issued a fact sheet addressing this issue. The Group recommends that the Department continue to highlight this issue in outreach materials and presentations when appropriate.

B. Use Tax

Many small businesses do not understand what use tax is and why it is due. This results in many small businesses not paying use tax when making purchases out-of-state or online. This is often discovered on an audit and results in significant assessments. The Department has tried to educate Vermonters on Use Tax through fact sheets and letter campaigns, but much of that has focused on individual use tax liability. The Group recommends that the Department continue its efforts and make Use Tax the topic of presentations at events hosted by industry groups.

C. Nonprofits

There exists a common misconception among non-profits that they are always tax-exempt. Specifically, organizations that are not 501(c)(3) organizations think they are exempt from sales tax when they are not.

D. Taxability of Online Products and Apps

The Sales and Use Tax treatment of transactions involving online products and apps on mobile devices is often unclear or confusing to small businesses. The Group recommends that the Department develop guidance on this issue.

2) Meals and Rooms Tax

A. Meals vs. Grocery Items

Small businesses that sell food are often confused if a given item should be treated as a grocery item on which no tax is due or a meal on which Meals Tax is due. The Department is finalizing an infographic to help provide guidance on this issue.

B. Nonprofits

The Meals Tax treatment of nonprofits is complex, as discussed later in this report. Restaurants, caterers, and nonprofits do not understand when meals are exempt to nonprofit organizations. The Department has content on its website regarding the tax treatment of nonprofits and is in the process of creating an outreach plan to these organizations

C. Bakery Items

Single serve bakery items are subject to Meals Tax when sold in quantities of one or two. They are not subject to Meals Tax when sold in quantities of three or more. This causes confusion among small businesses that sell bakery items. The Department has provided outreach on this through fact sheets discussing Meals and Rooms Tax. The Group recommends that the Department continue its efforts on this issue by discussing this in any outreach or presentation directed at businesses that may sell bakery items.

OPPORTUNITIES FOR THE DEPARTMENT TO MAXIMIZE ITS EXISTING RESOURCES TO PROVIDE ADDITIONAL RESOURCES TO SMALL BUSINESSES

This topic generated the most discussion on the listening tour and at the meeting of the working group. Stakeholders and businesses alike stressed that businesses have a strong desire to be in compliance, but it is sometimes hard to know what the law says.

Those attending both the Listening Tour and the Working Group recognized that the Department of Taxes has improved its website and posted more guidance on it, however noted that many small businesses do not go the Department of Taxes' website to get information. To address this issue, the Department intends to put a link on the online portal, myVTax, that businesses use to pay their taxes, including Sales and Use, Meals and Rooms, and Withholding taxes. The link will take businesses to a webpage with pertinent updates, both legislative and policy. This will put the information one click away from a website that virtually all small businesses visit on a monthly or quarterly basis.

The Department encourages taxpayers to contact it if they have questions about their responsibilities, but some taxpayers are reluctant to do so due to fear of being targeted for audit. The Department does not pursue audits based on questions received in other divisions. The Department will continue to tell the public that contacting the Department for guidance does not increase the likelihood of being audited.

The group encouraged the Department to create videos and host webinars so that small business owners can access content outside of working hours. These media have the benefit of being recorded and saved for later, allowing business owners flexibility with their schedules. The Department has begun creating video tutorials in the past year that have focused on how to file on myVTax. Businesses expressed interest in videos related to policy topics, so the Department should work with relevant organizations to conduct webinars.

Finally, the Department was encouraged to partner with existing third-party organizations when providing outreach and education. This will be discussed in detail below.

EXISTING OUTSIDE ORGANIZATIONS AND RESOURCES THE DEPARTMENT CAN USE TO SIMPLIFY LAW AND PROVIDE GUIDANCE TO SMALL BUSINESSES

There are several organizations and resources in Vermont that assist and have frequent interactions with small businesses. These resources include the Chambers of Commerce, Main Street Alliance, regional organizations such as BROCC in Southwestern Vermont, and industry groups like the Vermont Retail and Grocers Association and Vermont Fuel Dealers Association.

The group suggested that outreach is more effective when the Department partners with business and industry groups to create and distribute educational materials. One example of a recent successful outreach campaign was when the law was amended to apply sales tax to soft drinks. The Department partnered with the Vermont Retail and Grocers Association to conduct webinars and create educational materials. The Department has also partnered with the Vermont Fuel Dealers Association and the forestry industry to provide outreach on statutory changes that affected their respective industries. The Group recommends that the Department continue to partner with organizations whose members are affected by statutory changes or are the audience for new outreach or educational materials.

Business owners are hesitant to attend events sponsored by the Department. The Group recommends that the Department partner with an outside organization and present the outreach at an event hosted by that organization when looking to highlight an issue. This should increase the audience for the outreach and strengthen the partnership between the Department and the business community.

Another group that was identified as a potential resource for small businesses was the tax preparer community. The Department does make an earnest effort to involve tax preparers in its education and outreach campaigns. Examples include the Tax Technical Working Group and Vermont Tax Advisory Board – two boards established by the Commissioner to create an ongoing relationship with practitioners and business leaders. The Department seeks input from both these groups on a variety of topics. Department outreach staff also attends and presents at several preparer seminars throughout the year. The Department has attended and presented at 47 events so far in 2017. The Department also has an e-mail list to which preparers may subscribe to receive updates from the Department throughout the year. The Group recommends that the Department continue to engage with all groups with the hope that they will pass along relevant information to their clients.

The Group discussed that small businesses do not deal only with the Department of Taxes. They also deal with the Secretary of State, the Department of Labor, and, depending on the industry, various other state agencies. The Group recommends that the Department work with other state agencies to provide coordinated outreach and education. Agencies could coordinate an event or produce a coordinated document at the end of the legislative session that highlights all the legislative changes that may affect small businesses.

Finally, there was a sense that the Department does not involve the business community enough in the drafting of its Technical Bulletins and outreach materials. The Group recommends that the Department identify interested stakeholders when drafting Technical Bulletins and outreach materials and get organizations that represent them involved in the process before these documents are finalized. At the time of publishing this report, the Department has just implemented a public comment page on their website. This page includes three draft technical bulletins for comment and provides for an easy web form to submit comments to the Commissioner's Office. Moving forward the Department is committed to allowing a 30-day public comment period for all draft technical bulletins.

CONTACTING AND PROVIDING DIRECTION TO NEW SMALL BUSINESSES IN THEIR FIRST YEAR OF OPERATION

The registration documentation that a new business currently receives from the Department does not provide much tax guidance or inform the new business where it should seek tax guidance. The Group recommends that the Department provide guidance or direct small business to where such information is available in a package sent upon registration.

The Department partners with the Secretary of State and their online business portal. This partnership allows businesses to register to collect taxes when the business registers online with the Secretary of State. The online portal also provides some basic tax guidance. The Group recommends that the Department review the information currently on the Secretary of State's website and determine what additional information it could provide to a new business to assist in complying with tax responsibilities in the first year of operation.

Finally, the Group suggests that the registration process include a "wizard" where businesses can answer questions about their business and, based on those answers, be directed to applicable guidance. The Group recommends that the Department explore this suggestion and pursue creating such a wizard if it has sufficient technology and resources.

GUIDELINES FOR FORGIVING TAX, PENALTIES, AND INTEREST IN CERTAIN CIRCUMSTANCES

Sales Tax and Meals and Rooms Tax assessments are particularly difficult for small businesses to absorb. The tax that is assessed during the audit should have been charged by the business and paid by the consumer. But since the business failed to collect the tax at the time, it needs to pay the assessment out of its bottom line.

The concept of educational audits, during which the Department audits a business and reports its findings without assessing tax, interest, or penalty was discussed. Due to staff resources and a shrinking tax base, leading to continually acute revenue needs, full educational audits are implausible at this time, but something the Department would like to continue working towards. Other options that are more feasible can be implemented.

The Department has the option to "raise but not assess" on issues it deems appropriate. In these situations, the Department will inform a taxpayer that it is not charging tax correctly, but it does not assess back taxes on that issue. The Group recommends that this option be used more frequently in the following circumstances: where it is a first-time audit; tax was not collected by the vendor on the items sold; it is an issue the Department has flagged as complex or confusing; and there is no evidence of fraud or gross negligence.

Another option that was discussed was changing the penalty structure for sales and use and meals and rooms audits. Under the current structure, the general failure to pay penalty is 5% per month with a cap at 25%. On a 36-month audit, this means at least 31 months of the period will hit that 25% cap. The penalty for failure to pay due to gross negligence is a flat 25%. Therefore, most taxpayers will be paying as if they had committed gross negligence, even in situations where they did not, for most of their audit period. The Group recommends the Department review the penalty structure and propose a new penalty structure for first time assessments, such as a lower cap percentage. Factors that could trigger the lower penalty structure might include: first assessments; size of the business; percentage of tax underreported; and lack of fraud or gross negligence.

OTHER RECOMMENDATIONS

In addition to the specific areas directed by statute, there were a few other miscellaneous recommendations from the Group.

Businesses feel the Department is at times inconsistent in how it administers taxes to businesses. The Department has taken steps to address this perception in recent years. It created the Division of Policy, Outreach, and Legislative Affairs (POLA) that is charged with giving consistent policy advice and information in outreach materials. POLA also created a centralized ticketing system where tax examiners and auditors are encouraged to ask for guidance on interpretations of tax law. Policy analysts review the tickets and provide a written response to the examiner or auditor. This response is also e-mailed to all relevant divisions within the Department, so guidance is consistent. The Department is also creating a centralized database of its interpretations of tax law that we be accessible to all Department employees. The Group recommends that the Department continue these efforts and look for any other opportunities that are available to ensure consistency in the administration of taxes.

Businesses feel that they were not treated fairly when audited or that the Department was overly aggressive in assessing tax on transactions where the taxability was not clear. The Group recommends that the Department take steps to improve this perception and instead create one that all taxpayers are treated fairly. One example where the Department currently exhibits fairness is that auditors will review transactions where the taxpayer charged tax but should not and give the business a credit for the overpayment of tax.

Businesses that use a payroll service must provide the payroll service with the password to their myVTax account. This could create problems when the taxpayer changes the password. The Group recommends that, if possible, payroll services be issued a unique ID and password for withholding accounts.

Also, some preparers are frustrated that notices sent to them through the myVTax system do not specify the client name and, therefore, they do not know which of their many clients got a notice. The Department is aware of this issue and is in the process of revising its notices to contain the last four digits of taxpayer's account numbers in the notice.

Finally, the appeal and hearing process was discussed. Some taxpayers that have been audited feel that the hearing process lacks neutrality because the hearing officer is an employee of the Department. The possibility of having a neutral third party, such as a mediator hear appeals was discussed.

ALL RECOMMENDATIONS

- 1) The Legislature consider existing complexity in Sales and Use Tax and Meals and Rooms Tax when considering new exemption.
- 2) The Department provide outreach to restaurants, caterers, and nonprofits regarding the meals tax treatment of nonprofits.
- 3) The Department make Use Tax the topic of presentations at events hosted by industry groups.
- 4) The Department include explanation of Meals Tax treatment of bakery items in any outreach or presentation directed at businesses that may sell such items.
- 5) The Department highlight the clothing versus safety equipment issue in outreach materials and presentations when appropriate.
- 6) The Department put a link on the front page of the myVTax portal that businesses use to pay Sales and Use Tax, Meals and Rooms Tax, and Withholding Tax that takes business to a website with updates, legislative changes, and other important information.
- 7) The Department add language to its website assuring taxpayers that asking for guidance will not result in an audit.
- 8) The Department create more video and webinar outreach content.
- 9) The Department continue to partner with organizations whose members are affected by statutory changes or are the audience for new outreach or educational materials.
- 10) The Department partner with existing business organizations and present on tax issues at events hosted by those organizations.
- 11) The Department continue to engage with the tax preparer community with the hope that they will pass along relevant information to their clients.
- 12) The Department and other state agencies have a coordinated event or produce a coordinated document that highlights all the legislative changes that may affect small businesses.
- 13) The Department identify interested stakeholders when drafting Technical Bulletins and outreach materials and get organizations that represent them involved in the process before these documents are finalized. The Department does currently post Technical Bulletins to its website and allow for a comment period before finalizing the Technical Bulletin.
- 14) The Department provide guidance or direct small business to where guidance is available to new businesses upon registration.
- 15) The Department review the information currently on the Secretary of State's website and determine what additional information it could provide to a new business to assist in complying with tax responsibilities in the first year of operation.
- 16) The Department explore the possibility of a wizard that could direct new businesses to tax guidance relevant to their business and pursue creating such a wizard if it has sufficient technology and resources.
- 17) "Raised but not assessed" be used more frequently on issues where it is a first-time audit, tax was not collected by the vendor on the items sold, it is an issue the Department has flagged as complex or confusing, and there is no evidence of fraud or gross negligence.
- 18) The Department propose, and the Legislature enact, a new penalty structure for first time assessments, such as a lower cap percentage.
- 19) The Department continue its efforts and look for any other opportunities to ensure consistency in the administration of taxes.
- 20) The Department issue separate login credentials for payroll companies filing withholding returns.

LISTENING TOUR STOPS

August 10: St. Johnsbury

August 10: Montpelier

August 11: Burlington

August 24, Rutland

August 24: Bennington