

D.C. Tax Revision Commission Policy Options
Policy Option #2: Expand the Sales Tax Base to More Goods

MEMORANDUM

Proposal: Broaden the sales tax base to include non-prescription drugs and grocery food

Tax Type: Sales

Origin: William Fox

Commission Goal: Broaden the tax base

Current Law

D.C. exempts a select set of goods from the general sales tax. The two biggest exempt areas are non-prescription drugs and grocery-type foods purchased for consumption at home. Food purchased for immediate consumption—e.g. at a restaurant—is taxed.

Proposed Change

Extend the sales tax to the following goods:

1) Non-prescription drugs

D.C., Maryland and Virginia are among only 11 states that exempt non-prescription drugs from the sales tax. Illinois is the only state that taxes non-prescription drugs at a lower rate than its general sales tax. All other states without an exemption levy the full general sales tax on these items.

2) All grocery-type food

D.C. can either apply the full or a reduced sales tax rate for food purchased for consumption at home. For example, Virginia taxes grocery-type food at 2.5% instead of its statewide rate of 5.3%. Virginia is one of 14 states that levy the sales tax on grocery food—seven states apply the full rate and seven have created a lower rate. Maryland does not tax food purchased for use at home.

3) Select grocery items such as snacks

Apply the sales tax only to snack food—such as candy bars, potato chips and peanuts—purchased at a grocery or convenience store. D.C. previously had a so-called “snack tax” but it was repealed in the Tax Clarity Act of 2000. Soft drinks became a taxable item in 2011 and are taxed at the general sales tax rate of 5.75%.

Reason for Change

Expanding the sales tax base to non-prescription drugs and (some or all) grocery-type foods spreads D.C.’s sales tax over a larger range of goods.

Pros

- Lifting these exemptions expands the D.C. sales tax base and allows for new tax revenue or a lower general sales tax rate.
- A sales tax exemption for non-prescription drugs and grocery food, while created for low-income residents, provides tax relief to all consumers. This means non-residents and affluent consumers also benefit from the tax relief. Eliminating an exemption can be partnered with more targeted tax relief specifically aimed at the population the policy is supposed to benefit (low-income D.C. residents).
- Food purchases made via the Supplemental Nutrition Assistance Program (i.e. food stamps) are already exempt from taxation under federal law.

Cons

- Purchases of non-prescription drugs and food demand a disproportionate share of income from low-income residents. These residents would face a much larger tax burden if such exemptions are removed. Furthermore, attempts to provide tax relief via the income tax—rather than exempting these goods during the transaction—can be both difficult (not all low-income residents file income taxes) and problematic (the tax relief is provided just once a year).
- If D.C. decides to apply the sales tax to a good not taxed in Maryland or Virginia (such as non-prescription drugs) many consumers may decide to avoid these purchases in the District and instead leave the city to make a non-taxed transaction.

Revenue Impact

The Office of Revenue Analysis estimates the following revenue increases in the first year of implantation:

Apply the Sales Tax to The Following Goods	
All grocery-type food taxed at 2.5%	\$28 million
Snack food taxed at 2.5%	\$1.3 million
Snack food taxed at 5.75%	\$3 million
Non-prescription drugs	Unable to estimate