

Tri-State Automatic Merchandising Council, Inc. (Pennsylvania, New Jersey, Delaware)

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A State Council of National Automatic Merchandising Association
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Mr. Frank Breslin
Commissioner of Revenue
Philadelphia Department of Revenue
1401 John F Kennedy Blvd
Philadelphia, PA 19102

Via Email Only: chris.hazle-cary@phila.gov

October 17, 2016

RE: Comments on the Proposed Sugar-Sweetened Beverage Tax Regulations

Dear Commissioner Breslin:

This letter is on behalf of the Tri-State Automatic Merchandising Council, Inc. an affiliated state council of the National Automatic Merchandising Association (NAMA), in response to the request for comment on the City of Philadelphia's proposed regulations for the 1.5 cents per ounce sugar sweetened beverage tax (SBT) that is scheduled to go into effect January 1, 2017.

The Tri-State Automatic Merchandising Council is dedicated to promoting the common business interests and general welfare of the vending industry, improving the industry's service to the public, cooperating with government officials in advancing the public interest and improving conditions within the industry.

We are writing to comment on the regulatory burden that it will place on the affected companies in our industry, many of which are small businesses.

In addition to the regulatory burden explained in these comments this SBT will reduce sales resulting in a decrease in local and state revenue at a time when the City of Philadelphia is strapped for revenue, while concurrently forcing the City to undertake additional costs to administer the tax.

Most important, the regulatory burden that this SBT places upon the broad range of businesses and supply channels is simply untenable. This tax will apply to virtually all categories of non-alcoholic beverages *except* 100% juice, unsweetened coffee and tea, and pure milk products, and will include all syrup products. The administrative provisions of the proposed regulations as currently written will make compliance with the tax extremely challenging, particularly with invoicing and documentation requirements, physical size restrictions of warehouses and route delivery trucks, as well as the significant information technology burden it will require.

Applicability and Impact on Vending Machine Owners and Operators

Increased Costs on Vending Operators for Warehousing and Tracking

The proposed regulation places a tremendous burden on vending operators, referred to as Dealers or Registered Dealers in the proposed regulation. Many vending operators, specifically small businesses, do not have the infrastructure in place to track, as proposed by this regulation, what Sugar Sweetened Beverages (SB's) in their inventory will be sold in vending machines within the city limits.

Using the fact pattern in Example 4 of the proposed regulation and applying it to a small business vending operator whose business includes sales inside and outside the City of Philadelphia will help more fully explain the impact on the vending industry. The vending operator in such a fact pattern may have a warehouse or small garage located in or near the City, in which they warehouse their products. To properly track inventory and sales inside and outside the City on ALL SB's subject to the SBT will require an increase in the amount of physical space needed to separate these items. Assume a small vending operator is running their business operations out of a small garage or a large vending operator is in a commercial building with limited available space to expand their operations. This rule could make it nearly impossible for them to obtain the physical space needed for proper tracking and would result in a tremendous financial burden to move their business location or reduce the beverage choices sold to consumers in the City; both of which should not be the intended result of the regulation.

This requirement of more warehouse space, created by the compliance scheme of the proposed regulation, has a ripple impact on overhead costs for payroll, rent, accounting and compliance. Due to the already slim profit margins in the vending channel this could lead to businesses going out of business creating job losses in and around the City.

Like most industries the vending industry includes large, medium and small vending operator companies. Many large and medium size vending companies are further technologically advanced in their delivery, logistics and route management systems. The

assumption by many may be that the advanced technology would increase the ability to track SB's being sold inside and outside the City from a vending operator's warehouse. However, due to the proposed regulation's enforcement mechanism that assumption is most likely not accurate. Logistics and route management systems "pick" products by SKU or similar means. Therefore, a warehouse that holds product that is distributed to vending trucks that fill vending machines both inside the City and in neighboring areas would have to have two SKU's for each SB covered by the SBT. Similar to the situation mentioned earlier, this is most likely not possible from a warehouse space perspective or a route delivery truck perspective without increasing warehouse space or limiting choice. This would most likely lead to the vending operator limiting SB options that are sold in the City due to space constraints in the warehouse and truck fleet configurations. The ultimate result is less sales and choice of SB's sold in the City of Philadelphia and less SBT tax collected by the City.

Essentially, the tracking, warehousing and delivery systems created by the proposed rule will place a tremendous financial burden on vending operator's doing business in and near the City.

Increased Costs on Vending Operators for Recordkeeping and Compliance

The proposed regulation's compliance method places a difficult and onerous, if not impossible burden, on vending operators. The regulation requires that vending operators selling SB's in the City provide Distributors with notice that they are a Dealer. It also places the duty on the vending operator to provide the Distributor with the actual fluid ounces of SB's that they purchase from the Distributor that will be sold in the City of Philadelphia. Accuracy of this number will be very difficult to track and relay accurately to the Distributor due to issues raised previously in these comments.

Example 10 in the proposed rule describes a situation in which SB that is originally purchased for sale outside the City is transferred to provide more inventory to be sold in the City. This example would require that the vending operator/dealer track each bottle/container of product, by fluid ounce, that the SBT applies to and report on a monthly basis of inventory shortfalls for taxed product that are transferred from non-taxed inventory. This type of tracking is very burdensome for vending operators of all sizes and will require increased costs to implement a tracking/compliance inventory control system. The number of SKU's to track could be expansive (possibly over 100 products) when considering vending operators sell SB's covered by the SBT in multiple channels – vending, office coffee service, micro market and foodservice. ***This is a business cost with no return on investment.***

Also, filing electronically on a monthly basis with the Department of Revenue and/or with Distributors will be a compliance cost to be borne by the vending operator in an industry with already slim profit margins.

Significant Number of Beverages Taxed by the Rule Creates Financial Burden and Difficulty in Ascertaining Tax Application

Sections 101 (f) and 102 of the proposed rule delve into great detail describing what beverages are included and excluded in the application of the SBT. The applicability of the SBT is based on a list of caloric sweeteners that trigger the application of the SBT to the product. The regulation expands upon the applicability by discussing “sugars from concentrated fruit or vegetable juices that are in excess of what would be expected from the same volume of 100 percent fruit or vegetable juice of the same type” and provides examples of actual products. To further define the applicability the proposed rule discusses sugar substitutes or non-nutritive sweeteners and provides examples of products that might meet this test. The rule also discusses its applicability to coconut water and other water products. It then discusses beverages that are not “medical foods”.

Vending operators are not nutritionists and don’t typically have a nutritionist on staff. Placing the burden on vending operators to determine which products in their inventory are subject to the SBT isn’t feasible due to the technical nature of the proposed rules application by nutrition and product ingredient measurements. We request that the regulation be amended to include a process in which the Department would provide all impacted Dealers and Distributors, as described in Section 101 of the proposed rule, with a list of products that are covered by the SBT. Such a list will clarify applicability of the SBT allowing Dealers and Distributors to rely upon a trusted source to determine which products are subject to the SBT. Without this, impacted parties will have to employ nutritionists to review product ingredients and recipes on a consistent basis adding another burden of doing business with the City.

Purchasing of Products from Wholesale Clubs will Increase Costs and Limit Choice

Many vending operators purchase products from Wholesale Clubs like Sam’s Club, COSTCO Wholesale, BJ’s and Restaurant Depot, which would lead to confusion in SBT calculations, increased compliance costs and limited choice. If a vending operator purchases product from a wholesale club located inside the City, the club would most likely be a registered Distributor pursuant to the proposed rule’s definition. Therefore, the vending operator would assume that all SB’s sold at this store have the SBT included upon sale. If the vending operator intended to sell some of these products outside the City they would be paying tax on product that they couldn’t recover upon sale from the vending location outside the City limits. This issue would have to be resolved by the club store implementing a process for customers to track at point of sale to vending operators

or other Dealers. It would also create a situation where vending operators that do business inside and outside the City would be discouraged from purchasing from wholesale clubs inside the City. These operators would most likely purchase from wholesale clubs outside the City and be required to register as a Registered Dealer under the proposed rule's definitions, having a negative sales tax impact on the City due to lack of purchases of ancillary non-taxed items at wholesale clubs within the City, driving business outside the city limits.

If the vending operator chooses to purchase from the wholesale club outside of the City, their registration as a Registered Dealer for these products purchased at the wholesale club places an additional compliance cost and burden on the vending operator.

Compliance with Implementation Date Is Not Attainable

Section 201 of the proposed rule states that the date of imposition of the SBT is January 1, 2017. We would respectfully request that any compliance date be stayed until pending litigation regarding this SBT is resolved by the applicable judicial system or July 1, 2017 whichever is later. This extension if necessary due to the compliance challenges and financial burdens raised in these comments that make implementing a reliable compliance system nearly impossible within a two month period.

Compliance Costs Should Be Offset Consistent with Pennsylvania Sales Tax Law

As stated earlier, compliance costs associated with the proposed regulation could be significant on Dealers and Distributors. We would request that one (1%) percent of the tax due be retained by the Dealer or Distributor paying the tax. This is consistent with Pennsylvania law regarding timely sales tax payments. This would offset a small portion of these business expenses that are a direct result of this regulation's compliance scheme and would provide some limited relief.

Applicability and Impact on Distributors to the Vending Channel

The proposed rule also has tremendous financial burdens on the distributors to the vending channel. Many of the warehousing and product verification issues previously raised in these comments apply to distributors as well.

The compliance scheme in the proposed rule places a burden on Distributors to rely on Dealers to notify them by providing a state resale exemption certificate indicating they are located in the City. It also requires the Distributor to confirm receipt of notification and state on each invoice or supplemental to each invoice the amount of sugar beverage supplied (in fluid ounces) for both liquid and syrup beverage items as well as the amount of the tax imposed for each, including the volume that concentrates make according to

manufacturer's specifications. This will require daily monitoring of new items sold into the city to ensure proper set up and collection. The obligation of Distributors also includes reconciling of items shipped to the City but later used outside and vice versa. The entire reporting obligation will fall entirely to Dealers and Distributors.

We urge the City to meet with impacted vending operators (“Dealers”) and Distributors in a formal stakeholder meeting to discuss the compliance requirements in the proposed rule prior to a final regulation being issued. Our industry always seeks to comply with laws and regulations, regardless of our position on their application.

It is also important that the Department complete an on-site visit to a vending operator company prior to finalizing the rule. The industry has found these on-site visits very helpful in educating regulators on the intricacies and business practices of the vending industry and creating reasonable compliance processes that work within the existing industry practices and structure.

Lastly, we reiterate our request to meet with you as an industry to discuss issues surrounding compliance and the burden this proposed rule is placing on companies who do business in the City. We can't overstate the tremendous challenge and financial burden of compliance with the proposed regulation.

Thank you for the opportunity to comment on this important proposed regulation and we look forward to hearing from you to discuss the compliance challenges we have raised.

Sincerely,

/s/ Jeff West, Jr.
President