
Finance Committee

HB 1863

Brief Description: Implementing the streamlined sales and use tax agreement.

Sponsors: Representatives Gombosky, Cairnes and McIntire; by request of Department of Revenue.

Brief Summary of Bill

- Enacts an extensive set of changes recommended in the Streamlined Sales and Use Tax Agreement.
- Makes changes in the sales and use tax treatment of delivery charges, soft drinks, eyeglasses, and prosthetic items that will have at least moderate effects on amounts of taxes due.
- Makes other changes that affect the definitions and administrative provisions for sales and use taxes, but do not substantially affect amounts of taxes due.
- Does not implement the Streamlined Sales and Use Tax Agreement provisions that would change which local government gets sales tax revenue for goods shipped to a customer address; instead, provides for a study of this issue.

Hearing Date: 2/18/03

Staff: Bob Longman (786-7139).

Background:

Washington and 45 other states impose retail sales and use taxes. These taxes are imposed on the retail sale or use of most items of tangible personal property and some services. The rates, definitions, and administrative provisions relating to sales and use taxes vary greatly among the 7,500 state and local taxing jurisdictions. The overall status of sales and use taxation has been subject to considerable criticism. For example, the National Governors Association has described sales and use tax laws as "antiquated, terribly complex, and cumbersome to businesses in today's new economy." Criticism also comes from retailers, especially "remote" retailers, such as mail order companies and online sellers. Different rates and definitions of what is taxable in each jurisdiction make it difficult for remote sellers to calculate, collect, and remit sales taxes for the various state and local governments. Many

remote sellers decline to collect sales taxes, unless they are required by federal law to do so. A remote seller is required to collect sales tax for a state only if it has a physical presence in the state.

An effort was started in early 2000 by the Federation of Tax Administrators, the Multistate Tax Commission, the National Conference of State Legislatures, and the National Governors Association to simplify and modernize sales and use tax collection and administration. The effort is known as the Streamlined Sales Tax Project. The project seeks to incorporate uniform definitions within tax bases, simplify audit and administrative procedures, and explore emerging technologies to reduce the burdens of tax collection, for both main street and remote sellers. The Department of Revenue (Department) participates in this project under legislation enacted in 2002.

On November 12, 2002, members of the Streamlined Sales Tax Project voted to approve the Streamlined Sales and Use Tax Agreement (Agreement). The Agreement provides model tax rules designed to provide a "cooperative, simplified system for the application and administration of sales and use taxes." The Agreement does not invalidate or amend any provision of state law. Instead, the Agreement contemplates individual states amending their own sales and use tax laws to bring them into conformance with the Agreement.

Washington already conforms with several major provisions of the Agreement, which include: A uniform state and local tax base; a single state sales and use tax rate; a single local sales and use tax rate per taxing jurisdiction; and state administration of both state and local sales and use taxes.

Washington does not conform with all of the Agreement's provisions. Many of Washington's definitions and exemptions, which define what is taxable, vary greatly from the Agreement. In some cases, the difference is merely wording and phraseology, without significant difference in what is ultimately subject to tax. For some issues Washington would have to change what is subject to tax in order to conform with the Agreement.

Summary of Bill:

Many sales and use tax provisions are modified to conform with the Streamlined Sales and Use Tax Agreement. Several of the statutory modifications will not substantially change what is subject to tax, but will change the wording of Washington's statutes to be the same as other states that adopt the Agreement. These changes will not have a significant fiscal impact in terms of amount of revenue collected. Other statutory modifications will change what is subject to tax and will have fiscal impacts.

Provisions that significantly change what is subject to tax

Adoption of the Agreement's definitions requires inclusion of delivery charges in the taxable "purchase price" of repair services. Currently, delivery charges are part of the taxable purchase price for sales of goods, but not for sales of repair services.

The Agreement allows food to be taxable or exempt, at the option of individual states. If food is exempt, the Agreement provides definitions of food, soft drinks, and similar items

that must be used by states that adopt the Agreement. Washington currently exempts food. However, bottled water is currently taxed. The Agreement's definition of food requires exemption of bottled water. Juice beverages are currently exempt, while carbonated beverages are taxed. Under the Agreement, soft drinks are defined in a way that includes juice drinks containing less than 50 percent fruit juice and carbonated sodas. To comply with the Agreement, Washington could either exempt all soft drinks, giving up the tax on carbonated sodas, or tax all soft drinks which would extend tax to currently exempt juice drinks. The bill taxes soft drinks.

The Agreement allows eyeglasses to be taxable or exempt, at the option of individual states. Currently, Washington exempts prescription lenses but taxes eyeglass frames. The bill adopts the Agreement's definition of eyeglasses and exempts both prescription lenses and frames.

Washington exempts prosthetic items. The Agreement allows exemption of prosthetic items, but the required definition includes some orthotic items such as slings and repair parts that are currently taxed. The bill adopts the Agreement's definition of prosthetic device and exempts these items.

Provisions that do not significantly change what is subject to tax

Modifications of definitions that do not significantly change what is subject to tax

The following definitions are adopted or modified, but the changes do not appear to substantially change the law: "computer", "computer software", "prewritten computer software", "prescription" "drug", "over-the-counter drug", "prosthetic device", "durable medical goods", and "mobility enhancing equipment". Implementing the Agreement's versions of some of these definitions involves restructuring several exemptions into separate sections of law.

The Agreement defines "tangible personal property" that is subject to tax as including steam, electricity, and electrical energy. Steam, electricity, and electrical energy are not currently considered tangible property in Washington and are not subject to sales and use tax. The bill adopts the Agreement's definition of tangible personal property and provides additional sections to exempt steam, electricity, and electrical energy from sales and use taxes. Steam, electricity, and electrical energy are also excluded from the terms "ingredient," "component part," "incorporated into," "goods," "products," "byproducts," "materials," "consumables," and similar terms denoting tangible personal property so as to maintain the current tax treatment of these items.

Administrative provisions

The bill implements the Agreement's general administrative provisions where current law conflicts with the Agreement. Some of these provisions require statutory changes, but do not constitute any change in administrative practice. These include the method of rounding fractional amounts of sale and use tax, bad debt credit provisions, and a prohibition on independent sales and use tax audits by local governments.

A local sales and use tax rate increase imposed on services applies to the first billing period

starting on or after the effective date of the increase. A local sales and use tax rate decrease imposed on services applies to bills rendered on or after the effective date of the decrease. The Department is required to notify catalog sellers 120 days in advance of any boundary or local sales and use tax change. The Department is required to provide all other sellers with 60 days advance notice of any local sales and use tax change. Sellers who have not received timely notice of rate and boundary changes due to actions or omissions of the Department are not liable for the difference in the amount due until they have received the appropriate period of notice. Purchasers are still liable for any uncollected amounts of tax.

A purchaser's cause of action against the seller for over-collected sales or use tax does not accrue until the purchaser has provided written notice to the seller and the seller has sixty days to respond. The notice to the seller must contain the information necessary to determine the validity of the request.

The Department may not attribute nexus with Washington to any seller solely by virtue of the seller registering under the streamlined sales and use tax agreement.

Under the Agreement, sellers cannot be required to administer exemptions that have limits or caps on exemption amounts. Washington has sales and use exemptions for items incorporated into a prototype for aircraft parts, auxiliary equipment, or modifications. These exemptions are capped at \$100,000 per person per year. The bill changes these exemptions so that the sellers collect tax on these items, but the purchaser can request a refund of tax from the Department.

Sourcing

The process of determining where a transaction is taxable is commonly referred to as "sourcing." The bill adopts sourcing provisions specified in the Agreement. The Agreement contains two sets of sourcing rules. One set of sourcing rules is for telecommunication transactions. The telecommunications sourcing rules are consistent with current law, except for private communication services and "post-paid" calls that are paid with credit cards or billed to third numbers. A sale of private communication service is sourced to the jurisdiction in which the customer channel termination points are located. A sale of post-paid calling service is sourced to the origination point of the telecommunications signal. There are very few transactions that will be affected by the private communication and post-paid sourcing rules.

Another set of general sourcing rules in the Agreement is for all transactions other than telecommunications. In general, these rules provide that: (1) When a product is received by the purchaser at the business location of the seller (e.g., retail store), the sale is sourced at the seller's business location; and (2) When a product is *not* received at the seller's business location, then it is sourced at the place of receipt by the purchaser. The first rule is consistent with current law in Washington. The second rule is not entirely consistent with current law. If a product is shipped to a customer from business with a location in Washington, the transaction is sourced to the jurisdiction of the business location. This could be the location of a warehouse or the location of company main office in this state. Thus, the location of the warehouse or office gets any local sales and use tax due on the transaction under current law. Under the Agreement, the location of the customer would get the tax for

items shipped to the customer.

The bill does not adopt these general sourcing rules. Instead, the Department is directed to conduct a study of the fiscal impact on local jurisdictions of the sourcing provisions. The Department must use, and regularly consult, a committee composed of city and county officials to assist with the study. Committee responsibilities include identification of elements of the study including mitigation options for jurisdictions negatively impacted by the sourcing provision. The Department must report the results of the study, which at minimum must include the identification of the fiscal impacts on local governments of the sourcing provisions, by December 1, 2003, to the governor and fiscal committees of the legislature.

Appropriation: None.

Fiscal Note: Requested on February 12, 2003.

Effective Date: The bill takes effect on July 1, 2004.