

FINAL BILL REPORT

SB 5783

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Synopsis as Enacted

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

Sponsors: Senators Finkbeiner and Regala; by request of Department of Revenue.

Senate Committee on Ways & Means

House Committee on Finance

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. This variety is one reason cited in *Quill v. North Dakota*, 112 S.Ct. 1904 (1992), where the United States Supreme Court held that the federal commerce clause prohibits a state from requiring mail-order, and by extension internet, firms to collect sales tax unless they have a physical presence in the state. Physical presence is constituted by property, inventory, or employees 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 nationwide. 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, however, with all of the Agreement's provisions. For some issues, Washington will have to change what is subject to tax in order to conform with the Agreement.

Summary: Washington State sales and use tax statutes are modified to conform with many of the Agreement's provisions. These modifications relate either to defining taxable items

or to administrative provisions. Several of the definitions have fiscal impact in Washington, as they modify the scope of what is taxable, while the other definitions and the administrative provisions either will have no fiscal impact or the impact is offset by a new statutory exemption.

Definitions. The changes in definition to the following terms WILL have fiscal impacts:

1. "Sales price," "selling price," "purchase price," "value of article used," and "value of service used" are defined as equivalent terms. Current Washington law does not include delivery charges in the purchase price of repair services subject to use tax, but delivery charges are included under this new definition.
2. "Food and food ingredients," "prepared food," and "baked goods" -- Bottled water is currently taxed. The Agreement's definition of "food" exempts bottled water.
3. "Soft drinks" " Under the definition of "soft drink," beverages that contain less than 50 percent fruit juice are taxed.
4. "Prescription," "prosthetic device," "durable medical goods," and "mobility enhancing equipment" " Eyeglass frames purchased with prescription lenses are currently taxed, but will be exempt. Additionally, purchases of some orthotic items (slings), as well as repair parts, are currently taxed but will be exempt. All other items under these definitions will remain as they are currently treated under Washington law.

The changes in definition to the following terms will NOT have fiscal impacts:

"Delivery charges," "lease or rental," "computer," and "computer software." In addition, "prewritten computer software" is substituted for "canned software."

The changes in definition to the following terms would have fiscal impacts, but sections are included in the bill providing exemptions, to maintain the effect of current law. Therefore, these changes will NOT have fiscal impacts:

1. "Tangible personal property" includes steam and electricity, currently not taxed in Washington state, but a section is included in the bill to exempt them.
2. "Dietary supplement" " Purchases of dietary supplements are currently taxed, while purchases made pursuant to a prescription are exempt from tax. A separate statute is created to maintain the exempt status of dietary supplements purchased by prescription.
3. "Over-the-counter drug" and "drug" are defined and their exemptions are modified to reflect the new definitions.

Administrative Provisions. These provisions all adjust statute, yet only some change current practice, and none changes revenues or expenditures significantly.

1. A prohibition on independent sales and use tax audits by local governments on sellers registered under the Agreement.

2. The method of rounding fractional amounts of sale and use tax.
3. Bad debt credit provisions.
4. 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 must 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.
5. 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 60 days to respond. The notice to the seller must contain the information necessary to determine the validity of the request.
6. 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.
7. 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. These exemptions are changed so that the sellers collect tax on these items, but the purchaser can request a refund of tax from the Department.
8. The process of determining where a transaction is taxable is commonly referred to as "sourcing." 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.
9. Sales and use taxes must be uniform within a jurisdiction, with the exceptions of (a) the use tax on natural gas or manufactured gas, (b) solid waste collection tax, (c) local public facility tax, (d) local lodging tax, and (e) the sale, rental, lease, or use of motor vehicles, aircraft, watercraft, modular homes, manufactured homes, or mobile homes.

Other. The Department must 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.

Votes on Final Passage:

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| Senate | 47 | 1 | |
| House | 83 | 14 | (House amended) |
| Senate | 47 | 1 | (Senate concurred) |

Effective: July 27, 2003

January 1, 2004 (Sections 301-305)

July 1, 2004 (Sections 101-104, 201-216, 401-412, 501, 502, 601-604, 701-704, 801, 901 and 902)