
Finance Committee

SSB 6594

Brief Description: Conforming Washington's tax structure to the streamlined sales and use tax agreement.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Regala, Prentice, Doumit, Eide, Keiser, Fairley, Franklin and Kline; by request of Governor Gregoire).

Brief Summary of Substitute Bill

- Makes changes to tax code to fully conform Washington to the terms of the Streamlined Sales and Use Tax Agreement (SSUTA).
- Provides full mitigation to jurisdictions that are negatively impacted by the adoption of the SSUTA sourcing provisions.

Hearing Date: 2/15/06

Staff: Mark Matteson (786-7145).

Background:

Streamlined Sales and Use Tax Agreement. In the 2002 session, the Legislature adopted the Simplified Sales and Use Tax Administration Act, which authorized the Department of Revenue (Department) to be a voting member in the Streamlined Sales Tax Project (SSTP), a multi-state effort to simplify state sales and use tax structures and make them more uniform. Many other states have also authorized such participation, and representatives have met to develop an agreement to govern the implementation of the SSTP. This agreement, called the Streamlined Sales and Use Tax Agreement (SSUTA), was adopted by 34 states and Washington D.C. in November 2002.

During the 2003 legislative session, the Legislature enacted legislation at the request of the Department to implement the uniform definitions and administrative provisions of the SSUTA. However, the legislation did not implement six additional provisions that are necessary for the state to conform fully to the SSUTA.

The provisions concern:

- on-line registration of remote sellers;

- monetary allowance for sellers using certified service providers or tax compliance software. (Certified service providers are third parties that are authorized to collect and remit sales and use taxes to states that participate under the SSUTA);
- conditional amnesty for previously unregistered sellers;
- requirements governing the location to which tax is attributed during a transaction (i.e., "Sourcing");
- confidentiality and privacy protections for sellers using certified services providers; and
- the development of a taxability matrix to facilitate the administration of tax for sellers;

Since the 2003 session, the participating states have amended the SSUTA to include additional uniform definitions and provisions. These concern delivery charges; telecommunications; durable medical equipment, sales price, bundled transactions, geographic information systems (GIS), and exemption administration.

On October 1, 2005, the SSUTA agreement went into effect with 13 full members of the agreement and associate members. On January 1, 2006, an additional state became an associate member. Full members are those states that have fully complied with the agreement and associate members are those states that are expected to comply by January 1, 2008.

Local sales and use tax sourcing. Under the sales and use tax in Washington, local sales and use taxes are sourced according to the following rules:

- Sales tax from the sale of goods is sourced to the retail outlet at or from which delivery is made.
- Sales tax from the sale of a service, with or without a sale of goods, is sourced to the place where the service is primarily performed. Sales tax from the lease or rental of goods is sourced to the place of first use.
- In the case of short-term rentals, this is the place of business of the lessor. In the case of rentals or leases involving periodic payments, this is the primary place of use by the renter or lessee for each payment period.

In September 2004, the Department issued an updated study of the potential impacts from the adoption of the sourcing provisions of the SSUTA. The study indicated that the sales tax base for most local jurisdictions would be affected by the sourcing provisions, either adversely or positively.

Summary of Bill:

Provisions are included that would allow the state to conform fully to the Streamlined Sales and Use Tax Agreement.

Sellers are authorized to designate an agent to register the seller with the state. Sellers who agree to collect and remit sales and use taxes under the SSUTA must register through an on-line system authorized under the SSUTA.

The Department is required to adopt rules providing for monetary allowances for sellers who use certified service providers, tax compliance software, or another means of collecting and remitting tax that is authorized under the SSUTA. In addition, the Department may adopt rules to provide vendor compensation for sellers who collect and remit sales and use taxes to the state, but this authority is contingent upon action by Congress or the courts that would allow states to require

remote sellers to collect sales or use taxes. Monetary allowances and vendor compensation must be funded only from state sales and use taxes.

The Department is prohibited from making assessments for past uncollected sales and use taxes against an unregistered seller who, within 12 months of the effective date of the state's membership in the SSUTA, registers under the agreement and then collects and remits sales and use taxes to the state for a period of at least 36 months. This amnesty does not apply if the seller has already received an audit notice from the Department, with respect to sales and use taxes collected but not remitted by a seller, or with respect to sales or use taxes that are the seller's liability in its capacity as a buyer or consumer.

The SSUTA general sourcing rules are adopted effective July 1, 2007. The rules provide:

- (1) If a good or service is received by the purchaser at the business location of the seller, the sales tax is sourced to that business location;
- (2) If the good is not received by the purchaser at the business location of the seller, the sales tax is sourced to the location where receipt occurs, if known by the seller;
- (3) If neither of the first two rules apply, the sales tax is sourced to the address indicated for the purchaser in records normally maintained by the seller, if the use of this address by the seller does not constitute bad faith;
- (4) If none of the first three rules apply, the sales tax is sourced to the address for the purchaser obtained during the consummation of the sale, including the address of the purchaser's payment instrument, if the use of this address by the seller does not constitute bad faith; and
- (5) If none of the first four rules apply, the sales tax is sourced to the address from which delivery is made.

The general sourcing rules do not apply to purchases of motor vehicles, aircraft, watercraft, modular homes, manufactured homes, and mobile homes. In such purchases, the tax is sourced to the location from which delivery was made.

For the lease or rental of tangible personal property, tax is sourced depending on whether the lease or rental requires periodic payments. If periodic payments are required, tax on the first payment is sourced like sales of tangible personal property, but tax on subsequent payments are sourced to the primary property location of the lessee. If payments are not periodic, then tax is sourced like sales of tangible personal property.

The streamline sales and use tax mitigation account is created to mitigate the effect of the change in sourcing rules to negatively impacted local jurisdictions. On July 1, 2007, the State Treasurer must transfer \$28 million into the account from the general fund. Each July 1 thereafter, the Treasurer shall transfer an amount determined by the Department to fully mitigate negatively impacted local jurisdictions. Monies in the account may be spent only after appropriation. Mitigation for the first year will be determined by the Department from tax reporting data to determine actual losses less gains from voluntarily registered sellers. Beginning December 31, 2007, distributions from the account will be made quarterly. After the first year, DOR will determine each local jurisdiction's annual losses. Distributions will be made quarterly representing one-fourth of a jurisdiction's annual loss less voluntary compliance revenue from the previous quarter.

The Department must convene an oversight committee comprised of positively and negatively impacted local jurisdictions to assist in determining losses to be mitigated.

Public facility districts whose tax revenue is taken as a credit against the state sales tax may raise their tax up to .004 percent if their revenues have been reduced at least .5 percent. The district may only raise its tax by the least amount necessary to mitigate the reduction in sales and use tax collections.

Protections are provided with respect to confidentiality and privacy for businesses that use certified service providers under the SSUTA. Certified service providers are required to perform tax calculations, remittance, and reporting functions and may not retain the personally identifiable information of consumers, with very limited exceptions. The Department will provide public notification to consumers of its practices relating to the collection, use, and retention of personally identifiable information. Personally identifiable information will not be retained any longer than required to ensure the validity of exemptions.

The Department is required to complete a taxability matrix and will provide notice of changes in the taxability of products or services listed in the matrix. Sellers and certified service providers are relieved from liability to the state and to local jurisdictions for having charged or collected the incorrect amount of sales or use tax if the error resulted from reliance on erroneous information provided by the Department in the matrix.

The taxability of delivery charges is changed to allow sellers to apportion their delivery charges between taxable and nontaxable property within a shipment and apply tax to only that portion that represents delivery charges for taxable property.

Several telecommunication definitions recently incorporated into the SSUTA are adopted. These are changes to terminology in current law, but do not change current law regarding taxability and exemptions.

Durable medical equipment for home use is exempted from sales and use taxes.

For nebulizers, kidney dialysis machines, and medically prescribed oxygen systems used for other than home use, a process is created for purchasers to receive a refund of sales and use tax paid. These items are currently exempt from sales and use tax in Washington.

The four year time limitation on the duration of resale certificates is removed. The Department may not require sellers to renew or update blanket resale certificates for purchasers with whom they have a recurring business relationship.

"Bundled transactions" are defined as the retail sale of two or more products where the products are distinct and identifiable and the products are sold for one non-itemized price. Excluded from the definition are:

1. sales of tangible personal property and a service where the true object of the transaction is the service and the tangible personal property is essential to the use of the service;
2. the sale of two services where the true object is the second service and the first service is essential to use of the second service;
3. the sale of taxable and nontaxable products where the value of the taxable products is de minimis. De minimis means 10 percent or less of the value of the bundled products; and

4. the sale of taxable and exempt tangible personal property that includes food, drugs, durable medical equipment, mobility enhancing equipment, over-the-counter drugs, prosthetic devices, or medical supplies where the value of the taxable tangible personal property is 50 percent or less of the value of the bundled products.

"Bundled transactions" are subject to sales and use tax.

Sellers registered under SSUTA are required to use the Department's address-based GIS system to determine the correct rate and jurisdiction for local sales and use tax. Sellers who use the system are held harmless from errors resulting from proper use of the system. Sellers showing an undue hardship may be relieved of the requirement to use the address-based system and use a zip code-based technology provided by the Department.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The provisions of the bill concerning monetary allowances for participating retailers and the aspects of the definition of selling price concerning sales of bundled tangible personal property are effective July 1, 2006. The provisions concerning vendor compensation are effective when Congress or a court determines that the state may impose sales and use tax collection and remittance duties upon remote sellers. The telecommunications provisions that are contingent upon an adverse court ruling with respect to the Federal Mobile Telecommunications Sourcing act are effective 90 days after the session in which the bill passed. All other provisions of the bill are effective July 1, 2007.