
Finance Committee

HB 1072

Brief Description: Conforming Washington's tax structure to the Streamlined Sales and Use Tax Agreement (SSUTA).

Sponsors: Representatives McIntire, Condotta, Kagi, Hunter, Upthegrove, McCoy, Sells, Ericks, Kenney, Moeller, Quall and Haler; by request of Governor Gregoire.

Brief Summary of Bill

- Conforms Washington law to the SSUTA.
- Provides mitigation to local jurisdictions that are negatively impacted by the change to destination sourcing under the SSUTA.
- Provides relief to certain sellers impacted by the change to destination sourcing.

Hearing Date: 1/23/07

Staff: Jeff Mitchell (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. 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.

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 (SSTP).

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

In 2002, the Washington Legislature adopted the Simplified Sales and Use Tax Administration Act, which authorized the Department of Revenue (DOR) to be a voting member in the 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.

In 2003, the Washington Legislature enacted legislation at the request of the DOR to implement the uniform definitions and administrative provisions of the SSUTA. However, the legislation did not implement several provisions that are necessary for the state to conform fully to the SSUTA, including a provision that would require the state to change its local sales and use tax sourcing rules.

Under the sales and use tax laws in Washington, local sales and use taxes are sourced on an origin based system according to the following rules:

(1) Sales tax from the sale of goods is sourced to the retail outlet at or from which delivery is made;

(2) 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; and

(3) 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.

On October 1, 2005, the SSUTA went into effect with 13 full members of the agreement. To date, there are 15 full members of the SSUTA and six associate members. 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.

Summary of Bill:

HB 1072 bill includes seven material provisions necessary to conform Washington law to the SSUTA. These provisions are:

1. Monetary Allowances and Vendor Compensation: DOR 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, DOR 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.

2. Amnesty: DOR 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 DOR 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.

3. Sourcing: The sales and use tax sourcing rules are changed to a destination based system and become effective July 1, 2008. 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, aircrafts, watercrafts, modular homes, manufactured homes, and mobile homes. In such purchases, the tax is sourced to the location from which delivery was made.

4. Confidentiality: 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. Personally identifiable information will not be retained any longer than required to ensure the validity of exemptions.

5. Taxability Matrix: DOR is required to complete a taxability matrix to ensure uniform application of terms in the SSUTA. The matrix lists all products and services defined in the SSUTA and indicates whether the product or service is taxable or exempt. DOR must also 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 DOR in the matrix.

6. Definitions: The SSUTA requires uniformity in the language and application of definitions defined in the agreement. The following is a description of definitions that need to be modified in statute to conform with the SSUTA.

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.

The current sales tax exemption for prosthetic devices is extended to the component parts of prosthetic devices to conform with the SSUTA definition. For nebulizers, a device that converts liquid medication into a mist to be inhaled, 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.

"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 are de minimis. De minimis means that the taxable products are 10 percent or less of the total 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.

7. Administration: 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.

Sellers registered under SSUTA are required to use DOR's address-based Geographic Information 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.

HB 1072 bill also includes two material provisions that address fiscal impacts of the SSUTA in relation to local governments and small businesses. These provisions are:

1. Mitigation: 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, 2008, the State Treasurer must transfer \$31.6 million into the account from the general fund. Each July 1 thereafter, the Treasurer shall transfer an amount determined by the DOR to fully mitigate negatively impacted local jurisdictions. Mitigation for the first year will be determined by DOR from tax reporting data to determine actual losses less gains from voluntarily registered sellers. Beginning December 31, 2008, 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.

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

The Joint Legislative Audit and Review Committee is required to review, during calendar year 2010, whether the mitigation provisions address the needs of the jurisdictions most impacted by the sourcing changes and report to the legislature by December 31, 2010.

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 0.5 percent. The district may only raise its tax by the least amount necessary to mitigate the reduction in sales and use tax collections.

2. Small Business Relief: Small retailers, defined as having less than \$500,000 in gross income and at least 1 percent of their income derived from deliveries outside their home location, are relieved of penalty and interest from errors due to the sourcing changes. In addition, relief is provided for small retailers to allow them to either:

Use a certified service provider for up to two years, at no cost, for sales tax administration; or

Claim a credit against state sales tax liability in the amount of the costs of complying the sourcing changes. The total credit that any small retailer can claim cannot exceed \$1,000 and may be carried forward until used.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect on July 1, 2008, except for section 302, which is contingent on congressional or federal court action that allows sales and use taxation of remote sellers, and section 1003, which takes effect on the later of July 1, 2008, or the date Chapter 67, Laws of 2002, becomes null and void.