

HOUSE BILL REPORT

SSB 6594

As Reported by House Committee On: Finance

Title: An act relating to conforming Washington's tax structure to the streamlined sales and use tax agreement.

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 History:

Committee Activity:

Finance: 2/15/06, 2/23/06 [DP].

Brief Summary of Substitute Bill

- Makes changes to the 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.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 8 members: Representatives McIntire, Chair; Hunter, Vice Chair; Condotta, Conway, Ericks, Hasegawa, Santos and Shabro.

Minority Report: Do not pass. Signed by 3 members: Representatives Orcutt, Ranking Minority Member; Roach, Assistant Ranking Minority Member and Ahern.

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 goods are 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.
- (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 (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 (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, the 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.

Testimony For: This is the result of years of work. It will allow Washington to become a full member of the Streamlined Sales and Use Tax Agreement (Agreement). It will allow us

to collect tax that is already due. In addition, the bill allows for streamlined administration of the tax. It levels the playing field between brick and mortar retailers and on-line retailers. The bill includes mitigation to ensure locals won't be harmed. We are aware of 310 businesses that have already signed up under the Agreement.

This is by Governor request. More than 400 businesses have registered to date, indicating the level of interest among the business community. We hope that once the software is ready that can be used by a remote seller to calculate tax for every jurisdiction, there will be even more signing up. This is the fair thing to do. To the extent that remote sellers register and collect, the playing field will be leveled. This simplifies sales and use tax administration across participating states by providing common provisions for adoption. Washington is one of the most reliant states with respect to sales tax revenues. We need a structure that works.

This aligns an antiquated sales and use tax administration system with the needs of the 21st century. Leaving the old laws on the books can hurt retailers of all sizes.

For over 50 years, custom tire sales has been one of the largest components of our income. People are trained in our store to sell this product. The problem is that it is too easy for a potential customer to capture the benefit of our expertise and use the specifications to order products on-line. A custom wheel package can run between \$2,000 to \$4,000. We would like to get the playing field back even.

Amazon.com supports this legislation. We have spent a lot of time trying to deal with 20th century sales tax administration problems. The Apple iPod phenomena heralds the changes coming with respect to sales of movies and books. Changing the sourcing rules will eliminate confusion and complexity, especially for us. We have warehouses both in and out of state. For some of our transactions, a customer may receive products from two different warehouses, and under current law we would have to charge two different sales tax rates to Washington residents if the warehouses are in places with differing rates.

More businesses are going to volunteer to sign up under the agreement. Some without any connection or nexus will come forward. Some that are in a gray nexus area will come forward. And then some will come due to the amnesty provisions. Federal legislation has been introduced. They are waiting for the states to make the first step, and we need to step up.

On jewelry purchases, the tax may be substantial. We spend a lot of time explaining to customers why the tax is needed to support the state we live in. On a \$10,000 purchase, tax is \$840. A lot of times, this takes us right out of the sale. We do a lot of consumer counseling in the store for free, about the hazards of buying fake or counterfeit goods on-line.

This approach is the optimal one for cities. It includes full mitigation based on actual losses. If a city loses \$100,000 because of the sourcing changes, the loss might be offset by \$20,000 in a couple of years. While we don't know which firms have signed up, some have actually announced their participation publicly. In the process of ironing this out, we gathered positively impacted and negatively impacted cities, and agreed on an approach based on full

mitigation. This is our top legislative priority. Many cities have been struggling, and this will help. No supplemental reporting is required.

This is a win-win solution. Hundreds of hours have been devoted to the compromise effort. This is fair to local businesses. We need to support them, as they support us.

This is really important to cities like Kent, where the economy is built around storage, distribution, and international sales. The sales tax sourcing changes with respect to delivered goods would represent a loss of \$3.5 million to us. But we do support this legislation. It gets down to the fact that we are all benefitted in the long term. This will help drive tax equity on the national level. My husband and I own a small business, and we have seen potential customers purchase items on-line. This legislation is good because it fully mitigates sourcing losses, but not forever. The most important reason to support this is because it helps local businesses.

We did a survey of the counties, and many do not have a substantial retail tax base. However, these same counties do have many citizens who go elsewhere to make purchases. This bill is a fair and equitable collection and distribution of an existing tax.

There is a provision in the bill to recognize the issue of warehouse districts. The Puget Sound Regional Council of Governments is already looking at this to make sure our land use plans take into account land that is reserved for warehousing. We don't want this to become a disincentive to cities to allocate land for warehouse space.

For rural counties like Douglas, residents often have to go outside the jurisdiction to buy things like cars or washing machines. The mitigation will allow counties to be kept whole. There is a city that just annexed a development with a Costco. For the county, this is a big loss.

The sourcing changes are almost as important to Stevens County as the work done by the Columbia River Task Force. This does not offset losses due to initiatives 695 or 747, but it does help.

The Association of Washington Business supports this. Participation by the state on the Agreement's Governing Board is important to us. We are also pleased that there are no new reporting requirements in this proposal. We are also supporting a transitional approach - the amounts coming out of the General Fund should not be permanent.

One thing that has not been mentioned is the issue of apportionment in local business and occupation taxes. Local laws and the state law need to be in sync.

We are also concerned about the issue of industrial lands. Our position is that lands should continue to be made available and changing the sourcing laws should not affect land supply. There is a provision that, for the purposes of mitigation, cities should strive to maintain the supply of industrial lands. If, as a result of this legislation cities try to reduce this supply, we will be back to revisit the issue.

Washington Software Alliance supports this. It stays within the principle of "do no harm." It is good tax policy for the digital economy. Washington needs to be at the table to represent the issues of software developers like Microsoft. If there were an effective way to collect use tax currently, we would support it. It will require an act of Congress in order to compel all remote sellers to collect and remit taxes.

Mitigation is important to transit agencies that rely on sales taxes as well. Some are negatively impacted by the sourcing changes.

The exemption of all durable medical equipment other than mobility enhancing equipment will help many people, especially elderly persons on fixed incomes. This bill adopts language that simplifies confusing statutes on such equipment.

Testimony Against: None.

Persons Testifying: Senator Regala, prime sponsor; Senator Schoesler; Cindi Holmstrom, Department of Revenue; Jan Gee, Washington Retail Association; Charlie Extine, Washington Retail Association and Northwest Tire Dealers; Rick Prem, Amazon.com; Perry Saueressi, Washington Retail Association, Pacific Northwest Jewelers, and Ben Bridge; Pam Carter, Washington Association of Cities and City of Tukwilla; Kathy Keoller, Washington Association of Counties and city of Renton; Suzette Cook, Washington Association of Cities and city of Kent; Rose Bowman, Washington Association of Washington Officials and Lewis County; Julie Sexton; Washington Association of Counties; John Ladenburg, Pierce County; Mary Hunt, Douglas County; Merrill Ott, Stevens County; Amber Carter, Association of Washington Businesses; Greg Hanon, National Association of Industrial and Office Property; Lew McMurrin, Washington Software Association; Peter Thein, Washington State Transportation Association; and Thomas Coogan, Pacific Association of Medical Equipment Suppliers.

Persons Signed In To Testify But Not Testifying: None.