
Finance Committee

SSB 5581

Brief Description: Improving the effectiveness and adequacy of state tax laws by clarifying and simplifying nexus provisions, by decreasing compliance and administrative burdens for taxpayers and the department of revenue, by facilitating the collection of new tax revenue resulting from the United States supreme court's decision in South Dakota v. Wayfair, Inc., by providing more consistent tax obligations for both domestic and foreign sellers, and by simplifying the expiration of sales tax sourcing mitigation payments to local governments on September 30, 2019.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Rolfes, Braun, Carlyle, Keiser and Saldaña; by request of Department of Revenue).

Brief Summary of Substitute Bill

- Modifies the nexus threshold for marketplace facilitators and remote sellers to align state law with a recent United States Supreme Court decision.
- Eliminates the option for marketplace facilitators and remote sellers to elect to not collect tax and instead comply with notice and reporting requirements.
- Limits the import tax exemption to import sales involving a parent company and a wholly-owned subsidiary.
- Clarifies certain provisions under the Streamlined Sales and Use Tax Agreement and repeals sections related to local jurisdiction mitigation payments.

Hearing Date: 2/21/19

Staff: Tracey O'Brien (786-7152).

Background:

Business & Occupation Tax.

Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any

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deduction for the costs of doing business. Businesses must pay the B&O tax even though they may not have any profits or may be operating at a loss.

A taxpayer may have more than one B&O tax rate, depending on the types of activities conducted. Major B&O tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for services and for activities not classified elsewhere. Several preferential rates also apply to specific business activities.

A business does not have to file an annual B&O tax return if the business does not owe other taxes or fees to the Department of Revenue (DOR) and has annual gross proceeds of sales, gross income, or value of products for all B&O tax classifications of less than \$28,000 per year, or less than \$46,667 if at least 50 percent of its taxable income is from services or activities not classified elsewhere.

Retail Sales and Use Tax.

Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or end user of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use tax applies to the value of property, digital product, or service when used in this state. The state, all counties, and all cities levy retail sales and use taxes. The state sales and use tax rate is 6.5 percent; local sales and use tax rates vary from 0.5 percent to 3.9 percent, depending on the location.

Nexus.

Nexus is required before a taxing jurisdiction can impose taxes on an entity. In the case of retail sales taxes, nexus is necessary in determining whether an out-of-state business selling products into a state is liable for the collection of retail sales taxes for that state. Both the Dormant Commerce Clause and the Due Process Clause of the U.S. Constitution "pose distinct limits on the taxing powers of the States. Accordingly, while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause." (*Quill v. North Dakota*, 504 U.S. 298, 302 (1992)).

In evaluating a state's exercise of taxing powers under the Commerce Clause, the Court applies a four part test:

1. Is the tax applied to an activity with substantial nexus with the taxing state?
2. Is the tax fairly apportioned?
3. Does the tax discriminate against interstate commerce?
4. Is the tax fairly related to the services provided by the state?

Quill v. North Dakota

In 1992, the U.S. Supreme Court decided *Quill v. North Dakota*. The Court invalidated a North Dakota law that required businesses to collect a use tax from a consumer and remit it to the state. An analysis under the Due Process Clause focused on "whether a defendant had minimum contacts with the jurisdiction 'such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice.'" (*Id.* at 305 (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978))).

According to the Court, Commerce Clause and its nexus provisions focuses on the structural concerns related to the state's regulation and the impact on the national economy.

Applying the four part Commerce Clause test, the Court invalidated the North Dakota law as an undue burden on interstate commerce. As a result, *Quill* required a retailer to have a physical presence in a state in order to be obligated to collect and remit retail sales taxes.

Washington Nexus

The B&O tax is imposed on persons engaging in business in Washington that have a substantial nexus with the state. Substantial nexus occurs when an individual is a resident or domiciliary of the state, a business entity is organized or commercially domiciled in this state, or a nonresident meets certain economic thresholds. A nonresident has substantial nexus for B&O tax purposes if the individual or business has more than \$53,000 in property or payroll in the state, has more than \$267,000 in receipts in the state, or at least 25 percent of the individual or business's total property, payroll, or receipts are in Washington during the current or immediately preceding calendar year.

In 2015, Washington joined several other states and adopted "click-through" nexus. Under this nexus standard, certain remote sellers are required to collect and remit Washington retail sales tax for sales made into the state and may also have to pay B&O tax on their Washington sales.

A remote seller is covered by "click-through" nexus if the remote seller: (1) enters into agreements with Washington residents who, for a commission or other consideration, refer potential customers to the remote seller such as by a link on a website; and (2) generates more than \$10,000 in gross receipts during the prior calendar year under such agreements from sales into this state.

In 2017, Washington enacted "Marketplace Fairness" (EHB 2163, Part II) that gives out-of-state sellers the choice to collect and remit retail sales tax on sales made into Washington or to comply with notice and reporting requirements.

Sellers, other than referrers, choosing not to collect and remit retail sales tax must provide notices to consumers on two occasions: a general notice on the website and a notice on any invoice or sales receipt. The notice is intended to inform a Washington consumer that retail sales tax may be owed and that the seller is not collecting and remitting such a tax to Washington; therefore, the consumer may need to file a use tax return with the Washington Department of Revenue. In addition, a seller, other than a referrer, must send a yearly report to any purchaser that received item or service in Washington with a list of potentially covered sales and a reminder that the purchaser may owe Washington use tax. It will also send the DOR a list of Washington purchasers and details of the purchases that may be subject to use tax.

A referrer, who transfers potential purchasers to a seller, also has notice and reporting requirements if it chooses not to collect and remit retail sales tax. The referrer must have a general notice to consumers on its platform. The referrer also must send all of sellers that it referred a potential purchaser from Washington a notice that the seller was referred potential purchasers from Washington. The notice must state that the seller may have an obligation to send reports to both purchasers and the DOR if it did not collect and remit retail sales tax. In

addition, a referrer must send the DOR a list of sellers it referred potential purchasers to from Washington.

Wayfair v. South Dakota

In June 2018, the U.S. Supreme Court issued an opinion in *South Dakota v. Wayfair* (138 S. Ct. 2080 (2018)), overturning the long-standing *Quill* physical presence nexus precedent and upholding a South Dakota law that impose a sales tax collection obligation on sellers. The new "substantial nexus" standard allows a state to require a remote seller to collect or remit sales tax. The remote seller must have had gross sales over \$100,000 or at least 200 transactions in the state in the current or prior calendar year.

The Court found several features of the South Dakota tax system prevents discrimination or undue burdens upon interstate commerce: the protection of businesses that have limited transactions in South Dakota; the obligation applies only prospectively; the state's membership in Streamlined Sales Tax Agreement (SSUTA); and the systems standardization of taxes to reduce administrative and compliance costs.

Streamlined Sales and Use Tax Agreement.

In 2007, the Legislature fully adopted the SSUTA. The SSUTA includes provisions for determining where a sale is deemed to occur for local sales and use tax purposes. As part of that legislation, the Streamlined Sales and Use Tax Mitigation Account was created to mitigate the effect of the change in sourcing rules on negatively impacted local jurisdictions. The State Treasurer must transfer amounts determined by the DOR to fully mitigate negatively impacted local jurisdictions.

In 2017, the Legislature repealed local mitigation payments, effective October 1, 2019. Until that time, payments must be adjusted to reflect the impact of marketplace fairness on local tax revenues and will be made only to cities, counties, and public facilities districts.

The SSUTA also established certain 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. A "Model 1 seller" means a seller that has selected a certified service provider as its agent to perform all the seller's sales and use tax functions, other than the seller's obligation to remit tax on its own purchases.

Import and Export Commerce Tax Exemption.

Washington law provides the sale of tangible personal property that is in import or export commerce is not subject to B&O or retail sales tax.

Import commerce includes any tangible personal property in the process of import transportation. Property is in the process of import transportation from the time the property begins its transportation at a point outside of the United States until the time the property is delivered to the buyer in this state. Property is also in the process of import transportation while it is flowing through the state on its way to a destination in some other state or country.

However, property is no longer in the process of import transportation when it is:

- put to actual use in any state, territory, or possession of the United States for any purpose;

- resold by the importer or any other person after the property has arrived in this state or any other state, territory, or possession of the United States; or
- processed, handled, or otherwise stopped in transit for a business purpose other than shipping needs, if the processing, handling or other stoppage of transit occurs within the United States.

Tangible personal property is generally in export commerce when the seller delivers the property to the buyer at a destination in a foreign country. The export exemption applies with respect to property delivered to the buyer in this state if, at the time of delivery, it is certain that the process of export has begun. The export process begins when the property starts its final and certain continuous movement to a destination in a foreign country.

Summary of Bill:

Nexus.

A nonresident individual or a business entity is deemed to have substantial nexus in Washington if the individual or business entity has more than \$100,000 of cumulative gross receipts, or at least 200 transactions, in this state in the current or immediately preceding calendar year. The nexus standard applies retroactively beginning October 1, 2018. Only those receipts from retail sales sourced to Washington between October 1, 2019, through December 31, 2019, count for purposes of the gross receipts threshold.

The nexus threshold of at least 200 transactions in this state is eliminated effective with the passage of this act.

For marketplace facilitators, receipts and transactions counting towards the receipts and transactions thresholds include:

- receipts from the marketplace facilitator's own sales into this state; and
- receipts from marketplace seller's sales into this state through the marketplace facilitator's marketplace, including sales by marketplace sellers that do not have nexus with this state.

An individual or business establishing nexus must begin paying tax only on business activity occurring on and after the date nexus is established. A business that establishes nexus in one year is deemed to have nexus for the remainder of that year and the entire subsequent year.

The nexus standards related to property and payroll in the state are eliminated, including the standard established if an individual or business has at least 25 percent of their total property, payroll, or receipts in the state. The click-through nexus standard is eliminated. Inflation adjustments for the receipts threshold is eliminated.

Any person or business entity establishing nexus for B&O and retail sales tax purposes is required to pay all other applicable taxes and fees administered by the DOR.

The term seller includes marketplace facilitators, whether making sales in their own right or facilitating sales on behalf of marketplace sellers.

Marketplace means a physical or electronic place, including, but not limited to, a store, a booth, an Internet website, a catalog or a dedicated sales software application, where tangible personal property, digital codes and digital products, or services are offered for sale.

"Marketplace facilitator" means a person that:

- contracts with sellers to facilitate for consideration, regardless of whether deducted as fees from the transaction, the sale of the seller's products through a marketplace owned or operated by the person;
- engages directly or indirectly, through one or more affiliated persons, in transmitting or otherwise communicating the offer or acceptance between the buyer and seller; and
- engages directly or indirectly, through one or more affiliated persons, in certain specified activities with respect to the seller's products.

Marketplace facilitator does not include:

- a person who provides Internet advertising services, including listing products for sale, so long as the person does not also engage in other taxable activities; or
- a person with respect to the provision of travel agency services or the operation of a marketplace or that portion of a marketplace enabling consumers to purchase transient lodging accommodations in a hotel or other commercial transient lodging facility.

Referrers are removed from both the reporting requirements and the duty to collect and remit any applicable taxes.

Marketplace Facilitators.

Beginning October 1, 2018, marketplace facilitators must collect and remit retail sales tax on all taxable retail sales made or facilitated by the marketplace facilitator, whether in its own right or as an agent of a marketplace seller, regardless of whether the marketplace seller is subject to a tax collection obligation.

Beginning January 1, 2020, the collection obligation of a marketplace facilitator also applies to any other taxes and fees imposed on a retail sale made or facilitated by the marketplace facilitator, whether in its own right or as an agent of a marketplace seller, regardless of whether the marketplace seller has a tax collection obligation.

Liability relief provisions for marketplace facilitators and references to referrers are eliminated.

Prepared Food and Food Ingredients.

A definition of food sold with eating utensils provided by the seller is provided and applies when:

- it is the seller's customary practice to physically deliver or hand a utensil to the customer with the food or food ingredient as part of the sales transaction, including utensils that are prepackaged with the food or food ingredient;
- a plate, glass, cup, or bowl is necessary to receive the food or food ingredient, and the seller makes those utensils available to its customers; or
- the seller makes utensils available to its customers, and the seller has more than 75 percent prepared food sales.

A seller has more than 75 percent prepared food sales if the seller's gross retail sales of prepared food equal more than 75 percent of the seller's gross retail sales of all food and food ingredients, including prepared food, soft drinks, and dietary supplements. An exemption applies for prepared foods sold in servings of four or more as a single item.

Certain specified requirements for calculating a seller's annual percentage of prepared food sales are established.

Streamlined Sales and Use Tax Agreement.

The definition of "Model 1 Seller" is amended to include only those situations in which a seller has selected a certified service provider to perform its sales and use tax functions and outlined those functions in a contract between the streamlined sales tax governing board and the certified service provider.

The provisions for monetary allowances are modified to clarify that monetary allowances for certified service providers are available to those certified service providers selected by "Model 1 Sellers." Monetary allowances for certified service providers are limited to a base rate.

The DOR's discretionary authority to provide monetary allowances for sellers other than as required under the SSUTA is eliminated. The DOR may adopt rules re-imposing the use tax notice and reporting election provisions on remote sellers and marketplace facilitators if the agency determines that a subsequent change in federal law eliminates its ability to enforce a retail sales tax collection obligation on any remote sellers or marketplace facilitators.

Provisions requiring the DOR to determine total impact of marketplace fairness on local tax revenues for the purposes of making adjusted mitigation payments is eliminated.

Import Tax Exemption.

The import tax exemption is limited to only wholesale sales of tangible personal property in import commerce between a parent company and its wholly owned subsidiary.

Miscellaneous Provisions.

The act repeals, conforms with, or modifies a number of conflicting or obsolete statutes, and provides various effective dates.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available.

Effective Date:

- Sections 101, 104, 106, 201, 402, 403, 404, 405 and 501: emergency clause: immediately.
- Section 105, 301, 302, 401, 704: emergency clause: July 1, 2019.
- Sections 102, 103, 107, 701, 702 and 703: January 1, 2020.