

FINAL BILL REPORT

SSB 5581

C 8 L 18
Synopsis as Enacted

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).

Senate Committee on Ways & Means
House Committee on Finance

Background: 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 taxes apply to the value when used in this state. The state, most cities, and all counties levy retail sales and use taxes. The state sales and use tax rate is 6.5 percent. Local sales and use tax rates vary depending on the location.

Retail sales tax does not apply to the sale of food and food ingredients, except as provided in statute. The sale of prepared food is subject to retail sales tax. "Prepared food" means:

- food sold in a heated state or heated by the seller;
- food sold with eating utensils provided by the seller; or
- two or more food ingredients mixed or combined by the seller for sale as a single item, except as provided in statute.

Business and Occupation Tax. Washington's major business tax is the business and occupation (B&O) tax. B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. Businesses must pay the B&O tax even if they do not make any profits or are 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

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manufacturing, wholesaling, and extracting; and 1.5 percent for services, and activities not classified elsewhere. Several preferential rates also apply to specific business activities.

Nexus. Nexus is required before a taxing jurisdiction may impose taxes on an entity. In the case of sales or use taxes, nexus is necessary in determining whether an out-of-state business selling products into a state is liable for the collection of sales or use taxes for that state. A legal analysis of nexus involves the dormant commerce clause and the due process clause in the United States Constitution. If a tax violates either, it will be invalid. The dormant commerce clause analysis focuses on the structural concerns on the national economy and whether the tax inhibits interstate commerce. The due process clause analysis focuses on the authority of a state to impose the tax on a particular taxpayer.

In 2015, Washington adopted click through nexus. Under this nexus standard, certain remote sellers are required to collect and remit Washington sales tax for sales made into the state and may have to pay B&O tax on their Washington sales. A remote seller is covered by click through nexus if the remote seller enters into agreements with Washington residents who, for a commission or other consideration, refers potential customers to the remote seller, such as by a link on a website; and generates more than \$10,000 in gross receipts during the prior calendar year under such agreements from sales into this state.

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.

Remote Sellers, Referrers and Marketplace Facilitators. In 2017, the Legislature enacted marketplace fairness laws and started requiring remote sellers, marketplace facilitators, and referrers that meet the statutory criteria to remit retail sales or use tax, or comply with certain notice and reporting requirements. Penalty fees for non-compliance were also established under the same legislation.

The requirements to collect and remit tax or comply with notice and reporting requirements apply to marketplace facilitators or remote sellers that have gross receipts sourced to Washington of at least \$10,000. A referrer must comply with the requirements if during the current or previous calendar year, the gross business income received from its referral services sourced to Washington, whether or not they are subject to sales or use tax, is at least \$267,000. A seller that meets the nexus criteria in this act, but not the physical presence nexus, and who does not collect and remit sales or use tax on all taxable retail sales into Washington, must comply with the reporting and notice requirements.

The 2017 legislation also provided certain liability relief for unpaid taxes. A marketplace facilitator or referrer is relieved of liability for failure to collect the correct sales or use tax if it can show the error was due to incorrect information from an unaffiliated seller.

A marketplace facilitator is a person that contracts with sellers to facilitate, for consideration, regardless of whether it is deducted as fees from a transaction, the sale of the seller's products through a catalog or a physical or electronic marketplace, and engages:

- directly or indirectly, through one or more affiliated persons in (1) communicating an offer and acceptance between the buyer and seller; (2) owning or operating the infrastructure—electronic or physical—that brings buyers and sellers together; (3) providing virtual currency; or (4) software development or research and development related to the marketplace operated; and
- in any of the following activities with respect to sellers or producers (1) payment processing services; (2) fulfillment or storage services; (3) listing for sale for consideration; (4) setting prices; (5) branding sales as those of the marketplace facilitator; (6) order taking; (7) advertising or promotion; or (8) providing customer service and assistance with returns and exchanges.

A marketplace seller is a seller that makes retail sales through a physical or electronic marketplace operated by a marketplace facilitator, regardless of whether the seller is required to be registered with the Department of Revenue (DOR).

A referrer is a person who contracts or otherwise agrees with a seller to list or advertise for sale items in any medium; receives a commission, fee, or other consideration from a seller for listing or advertising; transfers a potential purchaser to a seller or an affiliated person to complete the sale; and does not collect receipts from the purchasers for the transaction. A referrer does not include a newspaper or a newspaper publisher, nor does it include a person who provides Internet advertising services and does not ever provide either the marketplace seller's shipping terms or advertise whether a marketplace seller charges sales tax.

A remote seller refers to any seller who does not have a physical presence in this state and makes sales to purchasers.

Wayfair Decision. On June 21, 2018, the United States Supreme Court decided *South Dakota v. Wayfair, Inc., et al. (Wayfair)* and overturned the physical-presence nexus requirement established under *Quill Corp. v. North Dakota (Quill)*. The *Quill* decision prohibited states from requiring mail order businesses to collect sales tax from customers located in the state, unless those sellers had a physical presence within the state. *Quill* has since been interpreted as applying to all types of remote sellers. Under *Quill*, no state could require remote sellers to collect retail sales tax unless they had a physical presence within that state.

Wayfair created a new substantial nexus standard. Under this new standard, a state can require a remote seller to collect sales tax “when the [remote seller] ‘avails itself of the substantial privilege of carrying on business’ in that jurisdiction.” *Wayfair* also upheld South Dakota’s law establishing dollar and transaction thresholds for mandatory retail sales tax collection. This law imposes a collection obligation on remote sellers with gross sales over \$100,000 or 200 or more transactions in the state in the current or prior calendar year.

Streamlined Sales and Use Tax Agreement. In 2007, the Legislature fully adopted the Streamlined Sales and Use Tax Agreement (SSUTA). 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 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 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 and 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 transit stoppage 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 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: 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 is applied 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 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.

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.

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

Provisions requiring 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 wholesale sales of tangible personal property in import commerce when the wholesale is (1) between a parent company and its wholly-owned subsidiary; or (2) the sale of unroasted coffee beans.

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

Votes on Final Passage:

Senate	33	13	
House	58	36	(House amended)
Senate	37	11	(Senate concurred)

Effective: March 14, 2019
July 1, 2019 (Sections 105, 301, 302, 401, and 704)
January 1, 2020 (Sections 102, 103, 107, and 701 through 703)