

DEPARTMENT OF TAXATION

2005 Fiscal Impact Statement

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| 1. Patron Emmett W. Hanger, Jr. | 2. Bill Number <u>SB 1135</u> |
| 3. Committee Senate Finance | House of Origin:
<u> X </u> Introduced
<u> </u> Substitute
<u> </u> Engrossed |
| 4. Title Retail Sales and Use Tax: Streamlined
Sales and Use Tax | Second House:
<u> </u> In Committee
<u> </u> Substitute
<u> </u> Enrolled |

5. Summary/Purpose:

This bill would conform the Virginia Retail Sales and Use Tax Act to many of the provisions of the National Streamlined Sales and Use Tax Agreement.

This bill would be effective July 1, 2006.

6. Fiscal Impact Estimates are: Unknown. (See Line 8.)

7. Budget amendment necessary: No.

8. Fiscal implications:

TAX is in the final stages of preparing for an August changeover to an entirely new system developed over many years through a public-private partnership. Legislative changes that become effective before the new system is in place must be made to both the old and new systems. However, TAX must “freeze” both systems for several months while its existing records and other data are converted to the new system, and will not be able to resume system modifications until the new system is stable. This freeze is required both by the physical requirements of a major system upgrade and the fact that all personnel capable of modifying either system will be fully committed to the changeover.

The effective date of this bill would require that substantial systems work be done during the “freeze” period required by the changeover. This work would include developing the necessary databases for use by merchants, the interface with the national centralized registration system under development, multiple forms revisions and the integration of these new systems into TAX’s system. While it is difficult to determine the exact cost to perform this work, due to the scope of the changes required and the uncertainty that still exists with the national project, the costs could be very significant. TAX has proposed an amendment to change the effective date of this bill to July 1, 2007, to ensure that there is adequate time to develop the new systems and meet with the business community to work through the issues that will impact vendors.

Until Congress requires out-of-state vendors to register and collect and remit sales and use taxes, any additional revenues would come from vendors who voluntarily register and file. It is impossible to determine the amount of revenue that will be received from voluntary registrants. However, in order for Virginia to benefit from any volunteer registrants or any future Congressional action, Virginia must conform its sales and use tax laws to the Streamlined Sales and Use Tax Agreement and must be found to be in substantial compliance with each of the requirements set forth in the agreement.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

To allow the Department to make the systems changes required by this bill after the new system has been brought on line and In order to allow time to ensure that there is adequate time to meet with the business community to work through the issues that will impact vendors, the Department suggest the following amendment:

Page 23, Line 1368, After July 1,
Strike: 2006
Insert: 2007

11. Other comments:

Streamlined Sales Tax Background

In the United States Supreme Court decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the court held that the Commerce Clause barred a state from compelling an out-of-state mail-order company to collect use tax on goods sold to customers located within the state because the company had no outlets, sales representatives, or significant property in the state. In *Quill*, the court determined that only Congress has the authority to require out of-state vendors, without a physical presence in a state, to register and collect that state's tax. In reaction to this decision, and in an attempt to create a level playing field whereby out-of-state vendors and in-state vendors are both operating under the same tax rules, 40 states and the District of Columbia have come together through the Streamlined Sales Tax Project (SSTP). The result of this collaborative effort is the Streamlined Sales and Use Tax Agreement (SSUTA), which serves as a model for states to conform their own sales and use tax laws to.

The SSTP originated as a cooperative effort between the National Conference of State Legislators, the Federation of Tax Administrators, and the National Governor's Association, with significant involvement from the private sector. The objective of the project is to simplify sales tax administration amongst the states, thereby making it easier for multistate retailers to collect state sales tax in both in-state and out-of-state transactions.

The Streamlined Sales and Use Tax Agreement (SSUTA) seeks to improve sales and use tax administration and create uniformity amongst the sales through:

- State level administration of sales and use tax collections.
- Uniformity in the state and local tax bases.
- Uniformity of major tax base definitions.
- Central, electronic registration system for all member states.
- Simplification of state and local tax rates.
- Uniform sourcing rules for all taxable transactions.
- Simplified administration of exemptions.
- Simplified tax returns.
- Simplification of tax remittances.
- Protection of consumer privacy.

In order for a state to benefit from filers who voluntarily come forward under the terms of the SUTA, or to benefit from any future Congressional action overturning the *Quill* decision, a state must conform its laws to the terms of the agreement. To date, several states have passed legislation in an attempt to conform to the SSUTA. These states must submit a certificate of compliance to a review panel, documenting their compliance with the provisions of the SSUTA. In order to be admitted for membership, a state must be found to be in substantial compliance with each of requirements set forth in the SSUTA.

The SSUTA becomes effective the first day of the calendar quarter at least sixty days after at least 10 states representing 20% of the sales tax imposing population have been found to be in substantial compliance with the agreement. Currently, the agreement is expected to become effective on October 1, 2005, as several states are scheduled to implement their SSUTA conforming legislation on July 1, 2005.

Virginia's consistency with the agreement

In many ways, Virginia's sales tax law is more consistent with the SSUTA than most other states. Virginia's sales tax law already meets three important requirements under the agreement:

- State level administration of sales and use tax.

Virginia's sales and use tax is centrally administered by the Department of Taxation. All registrations, payments, rules, regulations, and audits are done by the Department.

- Uniformity in state and local tax bases.

The base upon which the tax is applied (or not applied) is uniform. In Virginia, unlike some other states, the same items are either taxable or exempt for purposes of both the state and local sales tax. The only exception under current law is fuel for domestic consumption. Home heating fuels are exempt from the state sales tax; however, the local exemption is permissive.

- Simplification of state and local tax rates.

Unlike most other states, Virginia's 1% local rate is applied by all localities statewide.

Changes necessary for Virginia to conform to the SSUTA

Virginia's ability to continue to set sales tax policy will be preserved, even if Virginia conforms its sales tax laws to the terms of the agreement. The agreement requires that states adopt uniform definitions and procedures. However, states will independently determine the taxability of transactions and items based on uniform definitions. However, conformity to the agreement will require some changes to Virginia's laws.

- Revised definitions for items such as food for home consumption and nonprescription drugs.

The definition adopted under the agreement does not use the same definition for "food for home consumption" that is used under Virginia law. The change in definitions will result in minor changes in the types of food or food products taxed at a lower rate. The same is true for the change in the definition from nonprescription drugs to over-the-counter drugs that would qualify for the Virginia exemption.

- Repeal of the partial exemption for maintenance contracts and commercial modular buildings

Since 1996, Virginia has taxed maintenance contracts that provide both services and tangible personal property at 50% of the value of the contract. Similarly, since 2000, Virginia has taxed certain modular buildings at 60% of their value. These partial exemptions appear to conflict with the agreement requirements and would be repealed with this legislation.

- Exclusion from some administrative requirements unique to Virginia sales tax dealers for volunteer registrants.

In order not to subject voluntary registrants who come forward under the terms of the agreement, certain administrative requirements related to registration, filing, penalties and dealer discounts are being revised.

- Revision of local meals tax definition of food to be consistent with the revised sales tax definition of food

To clarify that the same food and food items will be subject to the retail sales tax, the definition of food is being amended for purposes of the local meals tax.

Sourcing

The one area where Virginia is not in conformity with the agreement is related to the sourcing rules for the purposes of the local sales tax. This is being done to preserve the

status quo for Virginia dealers and to avoid the shifting of local sales tax revenue from one jurisdiction to another. Under the terms of the agreement, all sales, both interstate and intrastate, will be sourced on a "destination" basis. This means that unless the sale is consummated at the time of purchase, meaning that the purchaser takes possession of the goods at the time of the sale, the one percent local tax on the sale is sourced to the location where the goods are delivered. Currently, Virginia uses an "origin" sourcing system where goods are sourced to the dealer's location, regardless where they are used or delivered.

Conforming Virginia's laws to destination sourcing would most likely impose significant burdens on in-state dealers and may lead to revenue shifting between localities. Several states that have changed their local sourcing rules have encountered problems in implementation and resistance from in-state dealers. Kansas, which adopted the "destination" sourcing rules, enacted a yearlong period of relaxed enforcement in order to give dealers the time to adjust to the new sourcing rules, reprogram their point-of-sale systems, and to acquire the appropriate technology to implement the changes. Ohio, Tennessee, and Utah have adopted the "destination" sourcing rules, but have delayed implementation until 2005 due to concerns from vendors. Texas and Washington have adopted many of the provision of the agreement, except the sourcing rules.

This bill would follow the approach taken by Texas and Washington and adopt the agreement terms without changing to destination sourcing. While it is unlikely that the SSUTA will be amended to allow an origin sourcing system, there is a possibility that a small business exception will be added. Ohio is currently at the forefront of a movement to adopt a small business exception to the destination sourcing rules in the agreement. This would provide some relief for certain small vendors who do not make many out-of-state sales, and who would be greatly burdened by having to keep track of the many rates imposed by different in-state taxing jurisdictions.

This type of small business exception would not affect larger vendors who would still have to switch to destination sourcing, and would not stop the revenue shifts from occurring in localities. Furthermore, as Virginia, unlike many states, imposes only one local rate, the burden on small vendors is not as great as it is in those states that have hundreds of different local rates that vendors would be required to impose under destination sourcing rules.

cc : Secretary of Finance

Date: 1/24/2005 SM
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