

# DEPARTMENT OF TAXATION

## 2016 Fiscal Impact Statement

1. **Patron** Glenn R. Davis

3. **Committee** House Finance

4. **Title** Retail Sales and Use Tax; Conformity to Streamlined Sales Tax Agreement

2. **Bill Number** HB 969

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would conform the Virginia Retail Sales and Use Tax Act to the provisions of the national Streamlined Sales and Use Tax Agreement ("the SSUTA"), a multistate compact created to simplify sales and use tax administration for both retailers and state tax agencies in an effort to collect tax from remote business activities.

The provisions of this bill would become effective July 1, 2017.

6. **Budget amendment necessary:** Yes.

ITEM(S) 275, 277, Department of Taxation

7. **Fiscal Impact Estimates are:** Tentative. (See Line 8.)

#### 7a. **Expenditure Impact:**

| <i><b>Fiscal Year</b></i> | <i><b>Dollars</b></i> | <i><b>Positions</b></i> | <i><b>Fund</b></i> |
|---------------------------|-----------------------|-------------------------|--------------------|
| [2015-16]                 | \$0                   | 0                       | GF                 |
| [2016-17]                 | \$2.50 million        | 8                       | GF                 |
| [2017-18]                 | \$0.73 million        | 8                       | GF                 |
| [2018-19]                 | \$0.68 million        | 8                       | GF                 |
| [2019-20]                 | \$0.69 million        | 8                       | GF                 |
| [2020-21]                 | \$0.70 million        | 8                       | GF                 |
| [2021-22]                 | \$0.71 million        | 8                       | GF                 |

### 8. **Fiscal implications:**

#### Administrative Costs Impact

In order to simplify the filing process for remote retailers, this bill would require the Department of Taxation to make available for use by all sellers a "simplified electronic return ("SER"), on which sellers could report all sales and use taxes, rather than reporting each tax type separately. The Department would need to design a SER and update its systems to accommodate the filing of one return with multiple tax types, and close out all existing tax accounts to move them over to the simplified return process.

The Department would need to modify its systems in order to participate in the Streamlined Sales Tax Project's ("SSTP") online sales tax registration system. Additionally, the Department would need to develop and maintain a rates and boundary database and taxability matrix. The Department would also need to notify taxpayers, tax professionals, software companies, and other state and local government officials of these administrative changes. The bill would require eight additional full time employees to administer the amnesty program required under the SSUTA, cover an anticipated increase in requests for offers in compromise due to an increased taxpayer base, and oversee the rates, boundaries, and taxability databases.

In order to implement these changes, the Department would incur administrative costs of \$2.50 million in Fiscal Year 2017, \$0.73 million in Fiscal Year 2018, \$0.68 million in Fiscal Year 2019, \$0.69 million in Fiscal Year 2020, \$0.70 million in Fiscal Year 2021, and \$0.71 million in Fiscal Year 2022.

### Revenue Impact

This bill would result in a revenue gain to the Commonwealth and its localities, the magnitude of which is unknown. Virginia could receive approximately \$21.4 million in additional sales and use tax revenue from voluntary registrants if it were to become a full member of the Streamlined Sales and Use Tax Project. Because of the uncertainty of the requirements that may be in any federal legislation, it is impossible to determine the revenue impact associated with the enactment of federal legislation. Potentially, Virginia could see a revenue increase exceeding \$250 million annually if federal legislation were enacted. However, this is highly speculative.

### **Impact of Membership**

Until such time as Congress requires out-of-state vendors to register and collect sales and use taxes, the revenue impact of this proposal on Virginia would derive primarily from the tax paid by sellers who register voluntarily under the SSUTA to remit tax to Virginia. The estimate of additional revenues that would be generated from voluntary registrants is based on revenues received by states that are full members of the Streamlined Sales Tax Project. Once merchants have volunteered to register with the SSTP, they are required to collect and remit sales and use taxes for all states that are full members of the SSUTA. According to the Governing Board, voluntary collections by streamlined registered partners in full member states totaled \$316.02 million in 2014. Based upon tax collections from voluntary registrants in North Carolina, Virginia could yield approximately \$21.4 million in additional sales and use tax revenue if it were to become a full member of the Streamlined Sales and Use Tax Project. This estimate is tentative, however, because Virginia and North Carolina do not have identical sales tax bases and economies.

### **Impact of Conformity with SSUTA**

The revenue impact of this proposal does not include any revenue impact from changes to Virginia's Retail Sales and Use Tax resulting from Virginia conforming to the provisions and definitions in the SSUTA.

### *Definitional Changes*

The SSUTA requires definitional changes, most of which are expected to have no significant impact on revenue. Such terms as “dietary supplement”, “direct mail”, “over-the-counter drugs”, “sales price”, and “food” are terms that are currently not defined in the Virginia Sales and Use Tax Act or terms for which the revenue impact of adopting the SSUTA’s definition is minimal.

### *Other Changes in Application of Tax*

In order to conform to the SSUTA, Virginia would be required to repeal its law authorizing partial exemptions for maintenance contracts that provide for both parts and labor. The current statute, which became effective in 1996, reduces the taxable base by 50% for these maintenance contracts. In repealing this provision, maintenance contracts providing both repair or replacement parts and repair labor would be subject to sales tax on the full price, which would result in a revenue gain to the Commonwealth, the extent of which is unknown. Virginia’s current treatment of maintenance contracts that provide solely for the furnishing of labor (nontaxable) or solely for the furnishing of replacement parts (taxable) would not violate any provisions of the Agreement. The revenue estimate of this proposal does not reflect any revenue gain or loss associated with the repeal of Virginia’s partial exemption for maintenance contracts that provide both parts and labor.

Virginia would also need to repeal the statutory provision that grants localities discretion to impose local sales and use taxes on the sale of fuel for consumption in order to conform to SSUTA’s requirement that all local jurisdictions have a tax base identical with that at the state level. The state currently exempts home heating fuels. The impact of extending this exemption to all localities is unknown.

Additionally, Virginia would need to remove chainsaws from the list of items qualifying for exemption during the hurricane-preparedness sales tax holiday because SSUTA does not recognize these items tax-exempt during a disaster-preparedness holiday. The revenue gain from repealing this exemption is unknown.

Deriving revenue estimates for the other components of the SSUTA, such as the provision authorizing a refund when the amount of bad debt exceeds the amount of taxable sales, is also problematic, as there is not sufficient data available. The provision granting amnesty for uncollected or unpaid sales taxes for qualifying dealers is equally problematic because, given the Department’s inability to identify and collect from these sellers, any foregone revenues could not be characterized as revenue losses. Therefore, the revenue estimate of this proposal does not reflect any revenue impact associated with these changes.

### **Impact of Federal Legislation**

Recent federal bills seeking to grant remote sales tax collection authority to states contain provisions that would allow states the option of becoming a full member of the SSUTA or adopting minimum simplification requirements. The enactment of any such federal legislation could generate additional sales and use tax revenues in excess of \$250 million annually, whether Virginia becomes a full member of the SSUTA or adopts the minimum

simplification requirements set forth in the federal legislation. Because of the uncertainty of the requirements that may be in the federal legislation, however, this estimate is highly speculative.

It is likely that Virginia could begin exercising its remote collection authority sooner if it were to become a full member of SSUTA than if it were to adopt the minimum simplification requirements of any federal legislation. Under the terms of the most recent federal bill, states would be unable to exercise remote collection authority until one year after federal legislation is enacted, and would be prohibited from exercising the authority between October 1 and December 31 of the first calendar year beginning after the enactment date of federal legislation. Moreover, Streamlined states would need to wait until the 1<sup>st</sup> day of a month beginning 180 days after the state publishes notice of its intent to exercise the authority. Non-Streamlined states would need to wait until the first day of the calendar quarter that is at least 180 days after the date the state enacts legislation exercising this authority and implements each of the minimum simplification requirements in the federal bill.

**9. Specific agency or political subdivisions affected:**

Department of Taxation  
All localities

**10. Technical amendment necessary: No.**

**11. Other comments:**

Streamlined Sales Tax Background

In the United States Supreme Court decision of *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court determined that the Commerce Clause barred a state from requiring an out-of-state mail-order company to collect use tax on goods sold to customers located within the state when 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 came together through the SSTP and endorsed the concepts now embodied in the SSUTA.

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 make it easier for multistate retailers to collect state sales tax in both in-state and out-of-state transactions.

The agreement seeks to improve the sales and use tax administration systems used by the states 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 SSUTA or to benefit from any future Congressional action, a state must conform its sales and use tax laws to the terms of the SSUTA.

Currently, twenty-three states are in compliance with the SSUTA through their laws, rules, regulations, and policies, and are therefore deemed “full member states” under the SSUTA. These states include Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming. Tennessee has achieved substantial compliance with the SSUTA overall, but not with each provision, and is therefore deemed an “associate member state.”

#### Federal Remote Collection Authority Legislation

Congress has considered several bills that would address the Retail Sales and Use Taxability of remote sales made into states into which the seller has no physical presence. On May 6, 2013, the Marketplace Fairness Act (“MFA”), S. 743 passed the Senate by a vote of 69-27. The bill aimed to authorize states either meeting a number of specified simplification requirements or satisfying the requirements for full membership under the SSUTA to compel qualifying remote retailers to collect use taxes for sales made into those states. The bill stalled in the House Judiciary Committee. A similar version was introduced in 2015, but has not been considered.

Virginia’s 2013 transportation legislation contained provisions that would broadly conform to the requirements of the Marketplace Fairness Act, or any similar future federal legislation, contingent upon the passage of such federal legislation.

#### Virginia’s 2012 Legislation Addressing Certain Remote Retailers

Legislation enacted during the 2012 Session of the Virginia General Assembly and effective September 1, 2013, created a rebuttable presumption that effectively requires certain out-of-state dealers to register and collect Virginia Retail Sales and Use Tax. Out-of-state dealers belonging to a commonly controlled group in which a person or entity maintains a distribution center, warehouse, fulfillment center, office or similar location in Virginia that facilitates the delivery of tangible personal property sold by the out-of-state dealer are presumed to have nexus within the state of Virginia. Affected out-of-state dealers can rebut this presumption by demonstrating that the activities conducted by the

commonly controlled person in Virginia are not significantly associated with the dealer's ability to establish or maintain a market in Virginia for the dealer's sales.

### Virginia's Consistency with the Agreement

In many ways, Virginia's sales tax law is more consistent with the SSTP objectives than some states. Virginia's sales tax law already meets three of the important requirements under the SSUTA:

#### *State level administration of sales and use tax.*

Virginia's sales tax is centrally administered by the Department. All registrations, payments, rules and regulations, and audits are performed 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 subject to the sales and use tax or exempt for purposes of both the state and the 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. Virginia's 2013 transportation legislation repealed the local discretion to impose the tax on home heating fuels, contingent upon passage of federal legislation.

#### *Simplification of state and local tax rates.*

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

### Changes Necessary for Virginia to Conform to SSTP Agreement

#### *Sourcing*

A primary hurdle to Virginia's initial involvement in the SSTP was centered on the SSUTA's sourcing rules, which would have required Virginia merchants to source intrastate sales of tangible personal property to the location to which that property was shipped or delivered (destination-based sourcing). Virginia's longstanding policy has been to source intrastate sales to the location in which the tangible personal property was purchased (origin-based sourcing). As local revenue shifts would result from changing this longstanding policy, some local governments expressed stiff opposition to the change.

After a three-year effort by Virginia, Tennessee, Texas, Utah and other state representatives, an alternative sourcing provision, adopted on a temporary basis on December 12, 2007 by the Streamlined Sales Tax Governing Board, eliminated the need for Virginia to completely overhaul its policies concerning sourcing. The provision allows member states to source retail sales, excluding leases or rentals of tangible personal property, to the location in which the order is received, provided that the sale is an intrastate sale, and the recordkeeping system the seller uses to

calculate the proper amount of sales or use tax owed captures the location where and when the order is received. Sellers who do not satisfy these requirements must source sales in accordance with the destination-based sourcing provisions set forth in the SSUTA. The exception that would allow Virginia to continue to use origin-based sourcing was permanently adopted by the Streamlined Sales Tax Governing Board on September 30, 2009.

#### Revised definitions for certain items

##### Food:

The definition adopted under the agreement for “food and food ingredients” differs from the “food for home consumption” definition under Virginia law. The change in definitions will result in minor changes in the types of food or food products taxed at the lower rate applicable to food for home consumption in Virginia. For example, prepared foods available at the reduced “food for home consumption” rate for meals-on-wheels recipients, women residents of domestic violence shelters, physically or mentally handicapped persons who received prepared meals by nonprofit organizations, etc., would be subject to sales tax at the regular rate, rather than the current reduced rate, absent Virginia specifically exempting these transactions.

##### Durable Medical Equipment

Virginia’s definition for “durable medical equipment” would have to be revised to explicitly exclude mobility enhancing equipment and equipment worn in or on the body. Virginia could, however, retain the exemption for mobility enhancing equipment by separately identifying these items as exempt under *Va. Code* § 58.1-609.10. Virginia would also have to provide a separately listed exemption for items that are worn in or on the body. As the SSUTA allows states to limit durable medical equipment to items intended for home use, Virginia would not have to change that portion of its definition.

#### Repeal of election for gifts transactions

Since 2005, Virginia has authorized retailers carrying out gift transactions to elect to collect either the tax imposed by the state of the recipient or the tax imposed by Virginia, upon approval by the Tax Commissioner. Gift transactions are retail sales resulting from an order for tangible personal property placed by any means by any person that is for delivery to a recipient, other than the purchaser, located in another state. This provision would conflict with the SSUTA’s mandate that interstate sales be sourced according to the destination of the tangible personal property, and as such, must be repealed.

#### Repeal of partial exemption for maintenance contracts

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. The partial

exemption for modular homes is permissible under Section 323 of the Agreement, which allows caps and thresholds on the retail sale or transfer of modular homes. However, the partial exemption for maintenance contract conflicts with the SSUTA's definition of "sales price," which is:

[T]he total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller.

As such, the provision authorizing a partial exemption for maintenance contracts must be repealed. However, several proposals have been introduced at SSTP's Governing Board meetings that would require uniform treatment among the states for software maintenance contracts. It is possible that future actions by the Governing Board would allow Virginia and the other member states to reinstate a partial exemption for maintenance contracts.

#### *Change to Hurricane-Preparedness Sales Tax Holiday*

Virginia would need to adopt SSUTA's current "disaster-preparedness" sales tax holiday definitions, which would require removing chainsaws from the list of items qualifying for exemption during the hurricane-preparedness sales tax holiday.

#### *Computation Changes*

The bill would also require minor changes to the rules for computing sales and use tax liability. Because SSUTA prohibits member states from requiring sellers to collect taxes based on a bracket system, this bill would repeal Virginia's current bracket system. Under current law, if a dealer can show to the satisfaction of the Tax Commissioner that more than 85% of the total dollar volume of his gross taxable sales during the taxable month was from individual sales at prices of 10 cents or less each and that he was unable to adjust his prices in such manner as to prevent the economic incidence of the sales tax from falling on him, the Tax Commissioner shall determine the proper tax liability of the dealer based on that portion of the dealer's gross taxable sales that was from sales at prices of 11 cents or more.

#### *Additional registration and administrative requirements*

The SSUTA requires that member states participate in an online sales and use tax registration system; maintain several downloadable databases on which retailers can rely to determine rates, boundaries, and other information; make a Governing Board-approved simplified electronic return available for all sellers that conforms to SSUTA's requirements; utilize exemption certificates created and mandated by the Governing Board; maintain a taxability matrix, documenting changes in taxability for certain items and explaining the Department's administrative practices for certain issues; adopt a standardized transmission process to allow for receipt for uniform tax returns and other information, and review software submitted to the Governing Board for certification as



software fit to calculate the tax imposed by each jurisdiction. In addition, the SSUTA requires that remote sellers and consolidated providers be given adequate notice before any change in tax rates or local boundaries becomes effective.

### Amnesty

In order to comply with SSUTA, the bill would also grant amnesty to dealers that register through SSUTA, provided they were not previously registered to collect Virginia taxes in the twelve-month period preceding the effective date of Virginia's participation in SSUTA. Amnesty would be available provided the dealer continues to be registered and continues paying, collecting, and remitting applicable taxes for at least three years. Under the terms of the bill, amnesty would not be granted to a seller under audit, nor if sales or use taxes were already paid, remitted, or collected by the dealer and not yet remitted.

### Summary

This bill would conform the Virginia Retail Sales and Use Tax to the provisions of the SSUTA. Virginia sales tax law is more consistent with SSTP objectives than many other states. In order to conform to Streamlined, Virginia would be required to make several definitional changes, as well as repeal the election for gift transactions and the partial exemption for maintenance contracts. It is possible that future actions by the Governing Board would allow Virginia and the other member states to reinstate this partial exemption. Thus, the necessary changes to conform to SSUTA are minimal. If federal legislation is enacted that would authorize member states of SSUTA to require remote sellers to collect and remit their sales and use taxes, this would generate significant revenue for Virginia.

The provisions of this bill would take effect on July 1, 2017.

cc : Secretary of Finance

Date: 2/2/2016 KP  
DLAS File Name: HB969F161