



BRIEFLY

The Legislature is considering a bill to make the state's sales tax fully conform to the Streamlined Sale and Use Tax Agreement. Simplification and harmonization of state sales and use tax systems is good policy as it reduces compliance costs for businesses, particularly for multi-state businesses.

STREAMLINED SALES TAX ONCE AGAIN BEFORE LEGISLATURE

As consumer reliance on e-commerce continues to grow, erosion of the sales tax base concerns lawmakers in many states. Purchases made over the Internet from out-of-state-retailers escape the sales tax: The U.S Supreme Court has ruled that the complexity created by variations in state systems makes it unduly burdensome for a state to require out-of-state retailers to collect sales tax. The Streamlined Sales Tax Project is a multi-state effort to reduce this complexity by developing a uniform sales and use tax framework for adoption by the various states. If widely adopted, this common framework would significantly reduce the administrative burden imposed on multi-state businesses by the collection of state and local sales taxes. Ultimately the states hope that once sales and use tax laws are harmonized, either Congress or the Supreme Court will require out-of-state vendors to collect and remit sales taxes on interstate transactions.

Currently, the sales tax systems of thirteen states fully conform to the sales tax framework developed by the Project. Six additional states have enacted legislation that will ensure conformity by 2008, and more states are predicted to do so in the near future.

The sales tax is Washington State's single largest source of tax revenue. The state has been participating in the Project since 2002, and the Legislature is currently considering a bill to make Washington's sales tax fully conform to the streamlined sales tax framework.

RETAIL SALES AND USE TAXES

Washington is one of 46 states to impose a sales tax. The sales tax is a tax formally imposed on consumers and collected for the state by retailers. The complimentary "use tax" is intended to be collected on items purchased out-of-state or for which no sales tax has been paid. However, collection and enforcement of the use tax is difficult and non-compliance is high.

Washington currently levies state sales and use taxes of 6.5 percent with local tax rates ranging from 0.5 to 2.4 percent. The retail sales and use taxes were the largest source of revenue for the state government in 2006, responsible for 47.4 percent of taxes collected. Washington state residents avoid paying sales tax by buying from out-of-state retailers either across the border in Oregon or Idaho or by making purchases over the Internet.



In total 7,500 state and local jurisdictions across the country impose sales taxes, each with its own rates, definitions and administrative provisions. This administrative complexity was cited by the Supreme Court in *Quill v. North Dakota* as one reason that a state could not require mail-order (and by extension Internet) retailers to collect sales taxes unless they maintain a physical presence in the state.

Catalogue purchases had been a minor problem for sales tax collection for decades but with increasing reliance on Internet and other remote sellers there has been significant erosion in Washington's sales tax base. The Department of Revenue estimates the tax revenue lost in Washington State due to untaxed Internet purchases was \$626 million in 2006. The fact that their electronic counterparts allow customers to avoid paying sales tax leaves local "brick and mortar" stores at a competitive disadvantage.

STREAMLINED SALES TAX PROJECT

In March 2000 a number of states and the District of Columbia initiated the Streamlined Sales Tax Project (SSTP). The ultimate goal of the project is to convince Congress or the Supreme Court to require sales tax to be collected by remote sellers after a common tax framework is widely adopted. In 2002, Washington, along with 34 other states adopted the Streamlined Sales and Use Tax Agreement (SSUTA). On October 1, 2005 the SSUTA agreement went into effect when at least 10 states were found to be in substantial compliance with its provisions. Currently there are 13 states that have modified their sales tax system to fully comply with the agreement. Another 6 states have enacted legislation that will bring them into compliance by 2008.

Legislation enacted in 2003 had allowed Washington state to conform to the initial requirements for voting member status. Now that the agreement has officially come into effect, however, formal control of the agreement is limited to the smaller group of conforming states. Washington, therefore, is no longer a voting member of the agreement. In 2004 legislation that would have brought the state into further compliance failed to pass due to opposition from certain local governments who would have lost sales tax revenue.

The Department of Revenue argues that continued participation as a voting member is in the best interest of Washington State and its businesses while member states continue to adopt additional uniform definitions and standards to simplify sales and use tax administration. If Washington becomes a full member of the agreement the net increase in Washington's tax revenue is predicted to be \$25.7 million for fiscal year 2009 (OFM 2007). This new revenue will come from remote sellers who, under the agreement, can voluntarily register to collect and remit sales taxes and in return will receive amnesty for unpaid sales taxes. Revenues are expected to grow as more states and businesses join the SSUTA.

SOURCING

Failure of the 2004 legislation is largely attributed to concerns over revenue losses to certain cities due to the bill's sourcing provision. This regulation stipulates that sales be deemed to occur where the purchaser takes final delivery of the product rather than where the sale originates. For example, if a product is purchased from a store in Seattle but delivered to a residence in Des Moines from a warehouse in Kent, the SSUTA locates the



sale in Des Moines (“destination-based” sourcing). This sourcing rule is logical for taxing purchases made from remote sellers and the Internet. Washington is one of a minority of states that currently does not source a sale to its destination. Among those states that do not use destination-based sourcing Washington is unique in that it currently would locate the sale in our example at the warehouse in Kent rather than the store in Seattle.

This new regulation could lead to revenue losses for cities with significant warehousing districts, as these tax revenues would now be redistributed to the cities of the purchasers. For fiscal year 2009, Seatac, Des Moines, University Place and Sammamish are predicted to be the big winners each gaining between \$700,000 and \$900,000 in net revenue while Kent, Tukwila, Seattle and Bellevue stand to lose between \$2 and \$4 million each (DOR 2007). (Recalled that Washington State as a whole is expected to gain revenue.)

SB 5089/HB 1072

The Washington legislature is currently considering bills, Senate Bill 5089 and its companion House Bill 1072, which would bring the state into compliance with the agreement. The current bills attempt to resolve the shortcomings of the previous legislation by allowing negatively impacted jurisdictions to be compensated for their losses resulting from the change in sourcing regulations. The new legislation provides for full mitigation to negatively impacted jurisdictions through the creation of a mitigation account. The State Treasurer will transfer \$31.6 million from the general fund to the account in 2008 to compensate negatively impacted districts. The DOR will determine the amount of mitigation to be paid from tax reporting data to establish actual losses, minus gains from voluntarily registered sellers. After the first year mitigation will be based on a jurisdiction’s annual losses and be distributed quarterly. Mitigation is not permanent and will end when new revenue from voluntary compliance exceeds losses.

Also under these bills, remote sellers who voluntarily register to collect and remit sales tax on interstate purchases will receive amnesty for uncollected sales and use taxes as long as they register within 12 months of the state’s effective membership in SSUTA and collect and remit sales taxes to the state for at least 36 months. These sellers will also receive compensation for expenses associated with voluntary compliance. Monetary allowances will be made for using certified service providers, tax collecting software or other means of collecting and remitting taxes that is approved by the SSUTA. In 2009 revenue from voluntarily registered sellers is expected to be \$37.5 million for the state and \$11.5 million for local jurisdictions (OFM 2007). These revenues are expected to eventually offset any revenue losses to particular jurisdictions due to the sourcing changes.

DISCUSSION

As our 2004 analysis of the Streamline Sales and Use Tax Agreement (WRC 2004) concluded:

Simplification and harmonization of state sales and use tax systems is good policy as it reduces compliance costs for businesses, particularly for multi-state businesses.



The SSUTA-required sales and use tax sourcing rule is consistent with the sourcing rule that the Legislature recently specified for municipal B&O taxes beginning in 2008, which is an advantage. Having different sourcing rules for local sales and B&O taxes would complicate the tax accounting problem for businesses. . . .

Some will see the extension of sales and use taxes to currently untaxed remote sales as a tax hike. Others view the extension as simply better enforcement of existing taxes, which would make the system more fair and would level the playing field for in-state retailers facing tax-advantaged out-of-state competitors.

The gold standard for simplification would be a sales and use tax system under which each state's base was identical and where there was a single combined state and local rate which applied statewide for each state. However, that kind of simplification conflicts directly with the principles of self-governance that allow citizens of various state and local governments to determine how they want to be taxed and what tax burdens they are willing to bear.

REFERENCES

Department of Revenue (DOR). 2007. Streamlined Sales Tax Impacts for 2009-2012.

Office of Financial Management (OFM). 2007. SB 5089: Fiscal Note. Streamlined Sales & Use Tax.

Washington Research Council (WRC). 2004. Sourcing Complicates Tax Simplification.