

# **Streamlined Sales Tax Project**

## **A Report to the Legislature on the Streamlined Sales Tax Project**

### **Board of Governance**

Honorable Carole Migden, Chairwoman, Board of Equalization  
Honorable Steve Westly, State Controller and Chairman, Franchise Tax Board  
Honorable Roy Ashburn, California State Senate  
Honorable Debra Bowen, California State Senate  
Honorable Rudy Bermudez, California State Assembly  
Honorable Mark Wyland, California State Assembly  
Member, Department of Finance (to be appointed)

**September 23, 2004**

## **BOARD OF EQUALIZATION STAFF PARTICIPATION**

- BOE staff attended the SSTP meeting in Tampa, Florida on May 24 – 25, 2004. Staff participated in various workgroup meetings by providing information on California’s current sales and use tax laws, regulations, and policies.
- BOE staff has been asked to participate in a local tax workgroup to address issues facing local governments under the Streamlined Sales and Use Tax Agreement (SSUT Agreement). This workgroup will be comprised of representatives from states and local governments dealing with issues such as a change in the sourcing rules. Break out sessions at the SSTP meeting and teleconferences were held to discuss efforts states are taking to address local government issues. A representative from the League of California Cities was also invited to join the workgroup.
- BOE staff made two presentations to the League of California Cities:
  - California Society of Municipal Finance Officers – May 20, 2004
  - Revenue and Taxation Policy Committee – June 17, 2004

The presentations included an overview of the SSTP, California’s participation in the project, issues facing California and local governments, and California’s plan to analyze the SSUT Agreement. It was emphasized that this should be a cooperative effort between the state, local governments, and businesses. Local government representatives supported a cooperative review of the SSUT Agreement.

## **STATUS OF CONFORMING STATES**

The SSUT Agreement will become binding and take effect when at least 10 states comprising at least 20 percent of the total population, as determined by the 2000 Federal census, of all states imposing a state sales tax have been found to be in compliance with the requirements of the SSUT Agreement. The SSUT Agreement will take effect on the first day of a calendar quarter at least 60 days after the tenth state is found to be in compliance. To date, 21 states have passed legislation in an attempt to conform to the SSUT Agreement. These states must submit a certificate of compliance to document compliance with the provisions of the SSUT Agreement and cite applicable statutes, rules, regulations, or other authorities evidencing such compliance. A state is in compliance with the SSUT Agreement if the effect of the state’s laws, rules, regulations, and policies have been certified to be substantially compliant with each of the requirements set forth in the SSUT Agreement.

The certification process includes a review of the state’s certificate of compliance by the other conforming states and representatives from the business group. This review process has identified a number of issues that will prevent the certification of some states. Some of the issues identified are shown below.

- Failure to pass complete conforming legislation. The main provisions that were not passed are:
  - Amnesty provisions
  - Liability protection for retailers
  - Definition of medical equipment
  - Definition of sales price
  - General sourcing rules
  
- Delayed effective dates of conforming legislation.
  - A state cannot be certified to be in substantial compliance with the SSUT Agreement until the conforming legislation is effective. A number of states have effective dates in 2005 or provisions that the legislation is effective when the Governing Board is created.
  
- State's conforming legislation includes different interpretations of SSUT Agreement sections.
  - Definitions for prepared food. Several states used different criteria to determine when eating utensils are provided to the customer.
  - Definition of sales price. Several states differ on what amounts are included in the sales price of a purchased item. One difference is between states that tax the gross receipts of the retailer and states that tax the total payment by the customer when a manufacturer's rebate is involved.
  
- Phased in implementation of the general sourcing rules.
  - Several states will phase in the implementation of the general sourcing rules. The state may not be in substantial compliance with the SSUT Agreement until the phased in implementation is complete.

Several states are trying to address the general sourcing issues. Washington and Texas failed to pass the general sourcing provisions of the SSUT Agreement in their conforming legislation. Ohio, Kansas and Utah passed the general sourcing provisions in their conforming legislation but have experienced problems with the implementation. This has resulted in delayed or phased in implementation of the general sourcing provisions in these states.

Washington completed a study in December 2003 to determine the impact the general sourcing rules would have on local governments. They utilized resources from Washington State University Social and Economic Sciences Research Center and local governments. The study indicated that a number of cities and counties would be negatively affected by a change from origin-based sourcing to destination-based sourcing. Seven mitigation options were included in the study to assist the negatively affected cities and counties. However, to date no mitigation option has been adopted. Washington is currently in the process of reevaluating the results of the study and mitigation options.

Texas is currently in the process of completing a sourcing study and expects to have it completed by December 31, 2004.

The SSTP is currently working to clarify all of the above referenced issues and identify states that will need to pass additional conforming legislation. If a sufficient number of states pass the additional conforming legislation in early 2005, the SSUT Agreement thresholds could be met on July 1, 2005. Accordingly, the SSUT Agreement could take effect on October 1, 2005.

## **COMPARATIVE ANALYSIS OF SSUT AGREEMENT**

The comparative analysis currently underway by BOE staff involves a detailed review of each section of the SSUT Agreement and a comparison to California's Constitution, statutes, regulations, Policy and Procedure Manuals, and other information relating to the administration of sales and use tax. The review of some sections will require significant assistance and input from California's local governments, businesses, and possibly other sources. The complexity of the analysis will vary depending on the SSUT Agreement section being reviewed. Some sections will only require a brief analytical summary of the issues while others will require a lengthy analytical summary. The analysis will strive to identify the impact of conforming to the SSUT Agreement in the following areas:

- Changes necessary to California's Constitution, statutes, regulations, Policy and Procedure Manuals, etc,
- Tax revenues, including revenue shifts for local jurisdictions,
- Administrative and operational costs for the state and local governments, and
- Compliance and cost issues for businesses.

Although the analysis for each section will provide information on the impact of conforming to the SSUT Agreement, the full impact cannot be known until the analysis of the entire SSUT Agreement has been completed. A revenue estimate for electronic commerce and mail order sales must also be included in the final analysis of the SSUT Agreement.

The analysis for each SSUT Agreement section will be comprised of the following phases. The time devoted to each phase will differ depending on the complexity of the SSUT Agreement section being analyzed.

1. Complete analysis: BOE staff will complete an analysis of the SSUT Agreement section.
2. Public review and comment period: The completed analysis will be made available to local governments, businesses, and other interested parties for review and comment.
3. Public comment review: BOE staff will review and address issues or concerns received after the public review and comment period.
4. Identify impact study options: Identify options available to quantify the impact of conforming to the SSUT Agreement. Each option should include a description of the study plan and an estimate of costs and/or resources needed to complete the study.
5. Approval of impact study: Obtain appropriate approvals to complete the impact study.
6. Complete the impact study.
7. Submit to Board of Governance: Submit the completed analysis and impact study to the Board of Governance.

## SOURCING ISSUES

The sourcing sections of the SSUT Agreement are the first to be analyzed. The SSUT Agreement includes the following six sections relating to sourcing.

1. Section 309, Application of General Sourcing Rules and Exclusions From the Rules
2. Section 310, General Sourcing Rules
3. Section 311, General Sourcing Definitions
4. Section 313, Direct Mail Sourcing
5. Section 314, Telecommunication Sourcing Rules
6. Section 315, Telecommunication Sourcing Definitions

Sections 309, 310 and 311 will be analyzed together due to common and overlapping issues. A schedule for the analysis of the remaining sourcing sections will be provided in a subsequent report. The following are the expected completion dates for each phase for the above referenced sections.

Phase 1 – Complete analysis - October 29, 2004.

Phase 2 – Public review and comment period - December 31, 2004.

Phase 3 – Review public comments – January 31, 2005.

Phase 4 – Identify impact study options - April 30, 2005.

Phase 5 – Approval of impact study - Will be based on the results of Phase 4.

Phase 6 – Complete impact study - Will be based on the results of Phase 4 and Phase 5.

Phase 7 – Submit to Board of Governance - 30 days after the completion of Phase 6.

In accordance with the provisions of the SSUT Agreement, local tax will be sourced differently than currently provided for under California's sales and use tax laws when the property is not delivered to the customer at the business location of the seller. This is a significant change and could negatively affect some local taxing jurisdictions. The following is a summary of Sections 309, 310 and 311.

- **Section 309: *Application of General Sourcing Rules and Exclusions from the Rules***

Provides that each member state must agree to require sellers to source the retail sale of a product in accordance with SSUT Agreement Section 310, *General Sourcing Rules*, regardless of the characterization of the product. Sourcing rules only apply to the seller's retail sale of a product and do not affect the obligation of a purchaser or lessee to remit tax on the use of a product. Section 309 also excludes certain items from the General Sourcing Rules of Section 310.

The retail sale or transfers of the following items are excluded from the general sourcing rules:

- Watercraft
- Modular homes
- Manufactured homes
- Mobile homes
- Florist sales

The retail sale, excluding leases or rental, of the following items that do not qualify as transportation equipment as defined in the SSUT Agreement are excluded from the general sourcing rules:

- Motor vehicles
- Trailers
- Semi-trailers
- Aircraft

- **Section 310: General Sourcing Rules**

- A. The retail sale, excluding lease or rental, of a product shall be sourced as follows:
  1. When a product is received by the purchaser at the seller's business location, the sale is sourced to the business location.
  2. When a product is not received by the purchaser at the seller's business location, the sale is sourced to the location where the purchaser receives the property.
  3. When (1) and (2) do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available in the seller's records.
  4. When (1), (2), and (3) do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith.
  5. When none of the previous rules apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which the property was shipped.
- B. The lease or rental of tangible personal property, other than property identified in subsections (C) and (D), shall be sourced as follows:
  1. For a lease or rental that requires recurring periodic payments, the first periodic payment is sourced the same as a retail sale in accordance with the provisions of subsection (A). Periodic payments made subsequent to the first payment are sourced to the primary property location for each period covered by the payment, as indicated by an address for the property provided by the lessee.
  2. For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale in accordance with the provisions of (A) above.
- C. The lease or rental of motor vehicles, trailers, semi-trailers, or aircraft that do not qualify as transportation equipment, as defined in the SSUT Agreement, shall be sourced as follows:
  1. For a lease or rental that requires recurring periodic payments, each periodic payment is sourced to the primary property location as indicated by an address for the property provided by the lessee.
  2. For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale in accordance with the provisions of subsection (A).
- D. The retail sale, including lease or rental, of transportation equipment shall be sourced the same as a retail sale in accordance with provisions of subsection (A), notwithstanding the exclusion of lease or rental in subsection (A).

- **Section 311: General Sourcing Definitions**

For the purposes of Section 310, subsection (A), the terms “receive” and “receipt” means:

- A. Taking possession of tangible personal property,
- B. Making first use of service, or
- C. Taking possession or making first use of digital goods, whichever comes first.

The terms “receive” and “receipt” do not include possession by a shipping company on behalf of the purchaser.

The following California Revenue and Taxation Code sections and regulations relate to the information found in the Sections 309, 310, and 311 of the SSUT Agreement:

Section 6006	Sale
Section 6006.3	Lease
Section 6009.1	Storage and use - exclusion
Section 6010	Purchase
Section 6010.5	Place of sale
Section 6010.7	Sale and purchase – chemical toilet
Section 6011	Sales price
Section 6012	Gross receipts
Section 6012.6	Factory-built school building
Section 6012.7	Factory-built housing
Section 6012.8	Mobilehomes-installed as residences
Section 6012.9	Mobilehomes-installed as residences subject to property tax
Section 6016.3	Leased fixtures
Section 6022	Vehicle; motor vehicle
Section 6023	Mobile transportation equipment
Section 6024	One-way rental trucks
Section 6077	Retail florists
Section 6092.1	Lessors of mobile transportation equipment
Section 6094.1	Leases; election to pay use tax
Section 6203	Collection by retailer
Section 6244.5	Leases of qualifying manufacturing property; cost price
Section 6272	Vehicle
Section 6273	Vessel
Section 6274	Aircraft
Section 6366.1	Aircraft leased to common carriers, foreign governments, and nonresidents
Section 6368	Watercraft
Section 6368.1	Watercraft leased for use in interstate or foreign commerce or for commercial fishing
Section 6390	Rentals included in use tax or outside state
Section 6391	Prior leases
Section 6407	Prior leases
Section 7204.03	Place of sale; sale’s of jet fuel

Section 7205	Place of sale
Section 7205.1	Place of sale; leases of motor vehicles
Section 7261	Required provisions of the transactions tax
Section 7262	Required provisions of the use tax
Section 7263	Place of sale
Regulation 1502	Computer, programs, and data processing
Regulation 1521.4	Factory-built housing
Regulation 1571	Florists
Regulation 1593	Aircraft and aircraft parts
Regulation 1594	Watercraft
Regulation 1610	Vehicles, vessels, and aircraft
Regulation 1610.2	Mobilehomes and commercial coaches
Regulation 1628	Transportation charges
Regulation 1660	Leases of tangible personal property – in general
Regulation 1661	Leases of mobile transportation equipment
Regulation 1669	Demonstration, display and use of property held for resale - general
Regulation 1686	Receipts for tax paid to retailers
Regulation 1802	Place of sale and use for purposes of Bradley-Burns uniform local sales and use taxes
Regulation 1803	Application of tax
Regulation 1803.5	Long-term leases of motor vehicles
Regulation 1805	Aircraft common carriers
Regulation 1806	Construction contractors
Regulation 1822	Place of sale for purposes of transactions (sales) and use taxes
Regulation 1823	Application of transactions (sales) tax and use tax
Regulation 1823.5	Place of delivery of certain vehicles, aircraft and undocumented vessels
Regulation 1825	Aircraft common carriers
Regulation 1826	Construction contractors

## **SSTP MEETING SCHEDULE**

Future SSTP meetings are listed below.

SSTP Meeting – October 6, 2004, Nashville, TN.

Conforming States Meeting – October 7 – 8, 2004, Nashville, TN

Implementing States Meeting – November 16, 2004, Chicago, IL

SSTP Meeting – November 17 – 18, 2004, Chicago, IL.

## **FEDERAL LEGISLATION**

Legislation was introduced in Congress, S. 1736 and H.R. 3184, “Streamlined Sales and Use Tax Act,” to give those states that have been certified to be in substantial compliance with the SSUT Agreement the authority to require out-of-state sellers to collect tax from customers in their state.

A hearing may be held on these bills before the end of the year with other state and local tax issues. However, it is unlikely that any action will be taken on these bills this year. If no action is taken this year, similar bills will likely be introduced again next year.

## **SUMMARY**

BOE staff is continuing to work on the comparative analysis of the SSUT Agreement. Subsequent reports will include schedules for the analysis of other sections of the SSUT Agreement.

Additionally, BOE staff has been working in conjunction with the League of California Cities on the analysis of the SSUT Agreement and would like to include, to a greater degree, the involvement of California businesses. BOE staff has been in contact and discussed the SSUT Agreement with several representatives of California businesses and business organizations. However, BOE staff encourages more input from California businesses during the analysis. Accordingly, BOE staff will schedule a meeting prior to December 31, 2004, with representatives from California businesses to provide general information on the SSUT, the SSUT Agreement, and the status of the comparative analysis.