Streamlined Sales Tax

Overview – The Streamlined Sales Tax Agreement (SSTA) is a national effort started in 2000 by state governments to establish the infrastructure for states to collect taxes on Internet and out-of-state mail order purchases. Congress must ultimately authorize states to collect Internet taxes. The agreement also attempts to improve sales tax administration for 'Main Street' retailers and remote sellers, thereby reducing the burden of tax compliance on businesses. Currently, 22 states (including Washington) are members of the SSTA. Several other states are observing the process and may join at a later date.

Key Elements – The SSTA strives for a uniform tax base, which includes standard definitions for common items such as food, medical devices, and computer equipment. It simplifies rates by allowing only one sales tax rate for state government and one local rate for each taxing jurisdiction. It provides for state-level tax administration of all sales and use taxes, which reduces the burden of filing tax returns on businesses. Uniform sourcing rules are used to determine where sales taxes are collected. There is also simplified administration of use and entity-based exemptions, which makes purchasers liable for paying tax and any interest or penalties for claiming incorrect tax exemptions. Uniform audit procedures are used to limit the extent of audits on sellers participating in a Streamlined Sales Tax system. Finally, SSTA calls for state funding of sales tax collection costs and partial funding of new technology models for tax compliance, reducing business expenses for tax collection.

Legislative Action – In 2002 the Legislature authorized Washington state, through the Department of Revenue (DOR), to join the SSTA. DOR has been talking with other states about these issues for several years. In the 2003 session, the Legislature, at the request of DOR passed SB 5783 implementing a majority of the administrative provisions and uniform definitions of the agreement. Some technical corrections were made in 2004. The state adopted the remaining provisions of the agreement in 2007 (SSB 5089), and will become a full member on July 1, 2008.

Legislation passed pursuant to the SSTA over the past five years has changed the taxable status of certain goods. Several items that previously were taxed are now exempt: (1) bottled water; (2) eyeglass frames purchased with prescription lenses; (3) orthotic items, and (4) repair parts. Conversely, some products that were exempt are now taxed: (1) beverages that contain less than 50 percent fruit juice and (2) delivery charges now included in the purchase price of repair services.

SSTA and the Internet Tax – As previously noted the Agreement is putting all the pieces in place to allow states to collect taxes on remote purchases (including Internet purchases) if and when Congress authorizes them. According to the Department of Revenue, the state and local governments lose an estimated *$260 million in sales and use tax revenue annually* to remote sellers (i.e., out of state mail-order businesses and Internet purchases). Remote sales increased by 14 percent in 2006 according to the U.S. Census Bureau. These sales are expected to increase in the foreseeable future.

On October 1, 2005, 13 states representing 20 percent of the population officially implemented the SSTA. This action allowed companies to voluntarily begin collecting taxes on Internet purchases. Many larger companies such as Wal-Mart and Amazon.com already collect sales taxes on Internet purchases. The agreement is expected to gain more companies. There are now 22 states that fully comply with the agreement or are expected to be in full compliance within the next year.

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Destination Sourcing - Under the "destination-based" sourcing rules of the SSTA, sales tax revenues must be sent to the local government where the customer receives a good or service. This will not affect most sales tax purchases, but will significantly affect purchases involving goods or services that have to be delivered. The change to destination sourcing occurs on July 1, 2008 and will fundamentally change the way retailers collect sales taxes on deliveries and how the revenues are allocated to local governments.

Prior to implementation of SSTA, Washington used an "origin-based" sourcing system. Under this system, when you purchase a sofa in Bellevue, but live in Issaquah, the sales tax on the sofa is sent to the city of Bellevue. However, if the Bellevue retail outlet you purchased the sofa from delivers it to your home from a warehouse in Kent, then Kent would receive the sales tax revenue. In either case, Issaquah does not receive any revenue from that purchase.

Under destination sourcing, in the example cited above Issaquah receives the sales tax revenue from the sofa purchase. Bellevue and/ Kent lose out.

Destination sourcing negatively impacts local governments that have high concentrations of retail or warehouse businesses. However, it does provide sales tax revenues to many other jurisdictions, particularly rural areas and cities with small or no commercial tax bases. Local governments negatively affected by the change have agreed to accept aid using expected revenues from businesses that voluntarily collect sales taxes on out-of-state and Internet purchases. This is expected to generate about $32 million in 2008.

Retailers that deliver goods to customers outside of their business location (e.g. wineries, furniture stores) will have to know what the sales tax rate is in the area to which the good is being shipped. The changes do not affect sales of motor vehicles, aircraft, watercraft, and modular, manufactured and mobile homes. The changes also do not apply to sales that take place at the location of the business (e.g., purchasing clothes from Macy's or household items from Wal-Mart).

Businesses will either have to purchase software or use other methods to charge the correct sales tax rate for deliveries. Businesses may also use a nationally certified third-party service provider that can handle sales tax collections for business deliveries.

For certain small retailers, SSB 5089 included a one-time $1,000 tax credit for the cost of compliance or free use of certified third-party service providers for two years. Retailers are eligible if they:

- Gross less than $500,000 annually; and
- Receive at least 5 percent of their taxable sales income from deliveries; and
- Receive at least 1 percent of their taxable sales income from deliveries outside the jurisdiction where they collect the most sales tax.

However, many businesses do not qualify for this relief. Legislation to expand the small business relief program was considered in 2007 and 2008, but did not pass.

Issues and Outlook – Implementation of SSTA is a major issue for local retailers as they make the switch to destination sourcing. Possible legislation in the future most likely will focus on increasing state assistance to retailers to comply with the new sourcing rules. Local governments will also be monitoring revenue from voluntary tax collections to ensure distributions are made to negatively impacted jurisdictions.

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