

**Background Paper on the
Streamlined Sales and Use Tax Agreement**
Prepared by Staff of the Board of Equalization
for the
**Assembly Revenue and Taxation Committee's
Informational Hearing on
"The Streamlined Sales and Use Tax: How it Works and Why it
Should be Considered"**
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Background

The Streamlined Sales Tax Project (SSTP) is a collaborative effort created by state governments with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The SSTP was organized in 2000, and in 2002, it adopted the "Streamlined Sales and Use Tax Agreement (SSUTA)," which creates a blueprint for a simplified tax collection system and attempts to reduce the burden and cost of tax collection from sellers. The agreement addresses issues associated with tax collections, definitions of the tax base, uniformity of tax bases, electronic registration of sellers, simplification of tax rates, simplification of returns and remittances, uniform sourcing rules, as well as other issues.

In an effort to enable California to have a voice in the development of the SSUTA, Senate Bill 157 (Stats. 2003, Ch. 702), among other things, created in California a Board of Governance (BOG) to represent California in meetings related to the SSUTA. The California BOG consists of seven members: two members from both the Senate and the Assembly, one member each of the Franchise Tax Board and the Board of Equalization (BOE), and a member of the Department of Finance. The Chair of the BOE serves as the Chair of the BOG.

Under the implementing provisions of the SSUTA, the Agreement became effective when ten states representing at least twenty percent of the country's population substantially complied with the Agreement's provisions. This occurred on October 1, 2005.

Prior to October 1, 2005, the implementing States - which included California - had responsibility for the further development of specific tax provisions of the SSUTA, including the disposition of proposed amendments

and the resolution of interpretation requests. As an “implementing state,” California had a vote on all matters relating to the SSUTA. However, when the SSUTA became effective on October 1, 2005, the responsibility for the SSUTA was transferred to the Governing Board of the Project - comprised of states that have been certified to be in substantial compliance with the SSUTA effective October 1, 2005, or on a subsequent date, but before January 1, 2008.

As a result, only those states that have been so certified may vote on issues relating to the SSUTA. Accordingly, since that date, California has not had a vote on the final disposition of issues relating to the SSUTA, and may only participate in an advisory capacity. Additionally, although a budget change proposal was sought by the BOE to address the increased workload generated by California’s participation in the SSTP in its advisory capacity, the Governor’s 2006-07 Budget did not include any additional funding. Subsequently, at its April and May 2006 meetings, the BOE designated two of its Members to meet with the BOG appointing authorities for the Legislative Members (the Senate Pro Tem and the Assembly Speaker) and the Director of Department of Finance to determine what was the desired level of effort and resources that California should commit to participating in the SSTP in its advisory only capacity. Included in the discussions were the option of pursuing legislation to revise the composition of the BOG and the option of designating the BOE to assume the role and responsibilities of the BOG. The result of the meetings was that effective July 1, 2006, the BOE would no longer actively participate in an advisory only capacity in the SSTP. Instead, it was decided that the Multistate Tax Commission would monitor the SSTP and report discussions and actions to California, as it is doing currently.

The SSTP and California’s Sales and Use Tax Law

Although the goals of the Streamlined Sales and Use Tax Agreement are to reduce the compliance burden and simplify procedures and practices to make the payment and collection of sales and use taxes by retailers throughout the nation more efficient, it does present some challenges for California that would need to be addressed in both the short and long term.

- First, conforming California’s Sales and Use Tax Laws to the SSUTA itself would not necessarily result in the collection of any additional tax dollars from remote sellers that do not have nexus in California.

Participating states in the Project anticipate that the interstate agreement will lead to voluntary participation by businesses and the subsequent petitioning of Congress to allow states to require out-of-state collection of their sales or use taxes. However, the simplification effort would not in itself result in states being able to require that out-of-state sellers without nexus to begin collecting the sales or use tax. Rather, the interstate agreement represents an effort on behalf of the participating states to demonstrate to Congress that the simplified sales tax system does not impose unfair costs on out-of-state businesses and thus would not interfere with interstate commerce. Federal legislation would still be needed that would allow states to require out-of-state sellers without a physical presence in the taxing state to collect the use tax.

- A specific goal of the Streamlined Sales Tax Project and its Agreement is to provide states with a sales tax system that includes, among other things, uniform definitions within the sales and use tax laws.

Although the agreement states that the Legislatures of fully participating member states will continue to decide what is taxable or exempt, these Legislatures cannot deviate from the definitions set forth in the Agreement. If the Agreement defines a product, then a member state Legislature may exempt all items within that definition, but cannot exempt only part of the items included within that definition, unless the Agreement expressly permits the Legislature to do so, or unless the exemption is based on the use of the property (determined by the buyer's use of the product), or the entity making the purchase (i.e., an exemption based on who the purchaser is).

As an example, the Agreement currently includes diapers within its definition of "clothing" and does not permit the Legislature to deviate from that definition. California law does not currently exempt sales of clothing or diapers from the imposition of sales or use tax. Pursuant to the SSUTA, California's Legislature would not be able to provide a general exemption for diapers. Instead, the Legislature would have to create an "entity-based exemption" for diapers, such as an exemption for diapers purchased by day care facilities.

In order to become a Member State, California's Sales and Use Tax Law would be required to comply with definitions in the SSUTA. As just one example, the SSUTA includes a definition for "soft drinks" that includes both carbonated beverages (currently taxable in California) and beverages with fruit or vegetable drinks with less than 50% fruit or vegetable juice (currently constitutionally exempt in California). If California were to conform to the Agreement, sales of carbonated beverages would have to be exempted to conform to the definition. Another example includes charges for delivery. California generally exempts charges for delivery when the delivery is performed by someone other than the retailer, but imposes tax on delivery charges when the delivery is performed by the retailer. California would either have to exempt all delivery charges or tax all delivery charges.

- Another issue relates to the fact that the Agreement does not allow for partial exemptions, as the local tax base must match that of each particular state. A particular item or service must be taxed at both the state and local level. There are currently several partial exemptions in California law, where only a portion of the state sales and use tax rate is exempted, such as sales of teleproduction equipment and farm equipment. To conform to the Agreement, amendments would have to be made that would either repeal these exemptions in their entirety or expand the exemptions to apply to all the state, local and district taxes. Under the terms of the Agreement, if a State is found to be out of compliance with the Agreement, it will not be accepted into the interstate Agreement or it will be sanctioned or expelled by the other participating states.
- With respect to interpretive issues, a governing board is responsible for the interpretations of the Agreement, amendments to the Agreement and issue resolution. The governing board will be comprised of representatives of each member state of the Agreement. Each member state is entitled to one vote on the governing board. Essentially, by becoming a member State and adopting the terms of the Agreement, the role of the State Legislatures would be limited with respect to interpretation and enactment of state sales and use tax laws. Interpretive issues would solely be the responsibility of the governing board of the SSTEP, and each Member State has one equally weighted vote, regardless of population.

- Sourcing rules in the Agreement are different from California. Beginning January 1, 2010, the Agreement provides that a member state may source the retail sales to the location where the order is received by the seller. However, in California, generally, the sale is sourced where the principal negotiations of the sale took place, which could or could not be the location where the order is received by the seller. This change could affect local and district tax allocation and some local jurisdictions could be negatively or positively affected.
- There are provisions to compensate vendors for the collection of taxes. This would be a new concept for California.
- There would be many administrative challenges. Taxpayer education and enforcement of the requirements of the Agreement would need to be addressed. Each state must submit a taxability matrix and sellers and their certified service provider would be relieved of tax liability due to reliance on the matrix. With some exceptions, states would be required to give amnesty for uncollected or unpaid sales and/or use tax to retailers who register.

The full impact on California would not be known until the terms and definitions that are currently contained in the Agreement are fully evaluated as they relate to California's laws.

In summary, many sections of California's sales and use tax law would need rewriting, some exemptions would have to be reworded, repealed, modified, or expanded, and future interpretive control would be given to the governing board of the SSUTA. Further analysis would be needed to truly evaluate the impact on California sales and use tax law. Again, without an act of Congress, this does not extend any mandatory collection of use tax obligations to remote sellers outside of California that do not have nexus in this state, as currently defined.

SSTP Member States

States that are currently in compliance with the Streamlined Sales and Use Tax Agreement through its laws, rules, regulations, and policies:

Arkansas
Indiana
Iowa
Kansas
Kentucky
Michigan
Minnesota
North Carolina
North Dakota
Nebraska
Nevada

New Jersey
Ohio
Oklahoma
Rhode Island
South Dakota
Tennessee
Utah
Vermont
Washington
West Virginia
Wyoming

If you have any questions, or would like any additional information, please contact Margaret Shedd, Board of Equalization's Legislative Counsel at (916)322-2376 or Sheila Waters, Legislative Analyst at (916)445-6579.