

## **Joint Subcommittee to Study the Impact of Collecting Remote Sales Taxes on the Economy of the Commonwealth (HJR 176 - 2004)**

October 19, 2004

The Joint Subcommittee to Study the Impact of Collecting Remote Sales Taxes on the Economy of the Commonwealth (HJR 176 - 2004) held its third meeting on October 19, 2004.

The meeting started with a brief presentation by Barry Hawkins on behalf of the Virginia Petroleum, Convenience, and Grocery Association. He raised concerns that the following three practices of his member organizations may be negatively impacted under the Streamlined Sales and Use Tax Agreement (SSUTA):

1. Buy downs -- Under this practice, a manufacturer rebates a certain set amount to the retailer for each item of a particular product that is sold. The concern is that the rebate may be included in calculating the sales tax under the SSUTA even though the customer did not pay it, and is unaware that it is being paid.
2. Shelf space -- Some suppliers pay the retailer a certain amount for premium shelf space. The Association opposes any provision under the SSUTA that might impose a tax on these activities.
3. Advertising Cooperatives -- Some suppliers provide the retailer with a credit on future purchases in return for advertising the suppliers' brands. The Association opposes any provision under the SSUTA that might impose a tax on advertising cooperatives.

Next, Mark Haskins from Virginia Department of Taxation ("Tax") addressed provided information on follow-up issues from the previous meeting. At the beginning of his presentation he was asked by Senator Hanger to respond to the concerns of the first speaker about "buy downs." Mr. Haskins stated that this issue is under active debate by the member states of the SSUTA and that a final determination may be reached at their next meeting in mid-November

Mr. Haskins then presented information on two follow-up issues: (i) additional data regarding audits performed by Tax, and (ii) information regarding the destination sourcing requirement under SSUTA (i.e. the SSUTA requires that all sales taxes (interstate and intrastate) be paid to the locality where the goods are delivered, whereas Virginia, and several other states, require that intrastate sales tax be paid to the locality where the purchase is made).

Mr. Haskins presented a revenue and statistical summary of audit collections for Fiscal Year 01 and Fiscal Year 02 (see handouts on this site for the October 19th

meeting). He set forth various criteria for selecting audit candidates and emphasized that efforts are made to have auditors concentrate on the types of audits that result in a higher measure of assessments per hour of audit time. He said that the vast majority of audits are of businesses, and not individual consumers.

Mr. Haskins then provided information on the destination sourcing issue under SSUTA. He said that if Virginia were to adopt the destination sourcing requirement under the SSUTA, that it alone would not alter the total sales tax revenue for the Commonwealth, and would not alter the total amount going to localities, but that it would alter the allocation among localities for their local tax (i.e. some localities would be winners and some would be losers.) He spoke of what other states have done that have an origin-based intrastate sourcing rule like Virginia. For example, Texas and Washington have conformed to the SSUTA except for the sourcing requirement. Iowa, Kansas, Ohio, Tennessee, and Utah all have changed their sourcing requirements to comport with the SSUTA and all have had to delay the change because of in-state vendor complaints.

Mr. Haskins then provided an overview of the Washington State Department of Revenue's study regarding the impact that would occur in Washington should Washington change its sourcing rule to comport with the SSUTA (see handouts on this site of the October 19th meeting). Some of the results of this study reflect that: (i) almost all counties gain revenues, while two-thirds of the cities gain; (ii) cities that lose revenues generally contain businesses with warehouses or retail stores from which deliveries are made, or serve as a local business hub to a larger community; and (iii) jurisdictions that gain revenues have a relatively high population compared to their business base.

Steve DelBianco (a citizen member of the Joint Subcommittee) raised the issue of whether one potential resolution to the "sourcing issue" (to have one sourcing rule for intrastate sales and another for interstate sales) would run afoul under the Interstate Commerce Clause of the Constitution of the United States. Mr. DelBianco then presented other follow-up information from the previous meeting regarding the thousands of Virginia small businesses that do substantial business on "E-Bay."

Next on the agenda was Senator Hanger who provided his perspectives on remote sales tax collections. He recounted the history of how he came to be involved with SSUTA, dating back to his involvement in the Commission on the Future of Virginia's Cities, and his interest in examining the tax structure in Virginia in general. He had followed with interest the work and the report of the Commission on Virginia's State and Local Tax Structure for the 21st Century, a two-year study, whose membership was comprised solely of citizens (House Document 22 (2001)). One of the many recommendations of this Commission was to have Virginia participate in the SSUTA. Out of concern that the results of

this Commission would lay dormant, he was successful in getting a Joint Subcommittee of the General Assembly established to carry forward with the recommendations of the citizens' Commission (SJR 387 and HJR 685 (2001), and SJR 347 (2003)) . That Joint Subcommittee looked at the total state and local tax structure, and, like the citizens' Commission, recommended to continue working with the national Streamlined Sales Tax Project. Senator Hanger has been a part of the official Virginia legislative delegation participating in the SSUTP since the delegation's inception in 2002.

In the 2004 Session, Senator Hanger introduced legislation to conform Virginia's sales and use tax laws to the SSUTA, except for the destination based sourcing requirement under the SSUTA (SB 514). The legislation passed the Senate but was carried over by the House Finance Committee.

Senator Hanger addressed the sourcing rule issue by saying that in the short run, if Virginia can find a way to comport with the SSUTA without changing its sourcing rule then he would support that. However, he stated that, independent of the SSUTA, Virginia's sourcing rule is one of many aspects of the tax system that ought to be examined. He said that the current sourcing rule already creates "winners and losers" among localities that in many instances may not reflect sound public policy.

Senator Hanger spoke briefly on the Council on State Taxation's evaluation of the SSUTA. He said that the document helps to put in perspective the original goals of the SSUTA. He asked that staff provide a copy of this evaluation to each member.

As a general matter, he said that, compared with most other states, the uniformity and simplicity inherent in Virginia's current sales and use tax laws makes conformity with the SSUTA a much easier task, with most changes being technical in nature.

Chairman Hugo then invited any members who so desired to present any proposed findings and recommendations that the Joint Subcommittee might consider in arriving at its ultimate recommendations at its final meeting next month. Steve DelBianco was the only member to present proposed findings and recommendations (see handouts on this site of the October 19th meeting).

Mr. DelBianco provided an overview of his written draft of proposed findings and recommendations. His findings are divided into the following five subheadings:

1. Sales & Use Tax Compliance -- These findings relate to the need to analyze carefully the net additional revenue that Virginia may receive through a national, mandatory program as part of an overall cost-benefit analysis that should precede any final decision regarding conforming Virginia's laws to the SSUTA.

2. Costs and Burdens of Sales Tax Collections Imposed Upon Virginia Businesses -- These findings relate to the costs to vendors in collecting sales and use taxes under current laws, and the additional costs that may come under a national, mandatory program.
3. Increase in Taxes Collected from Virginia Consumers -- These findings relate to the additional taxes that would be paid by Virginia consumers to other states under a national, mandatory program.
4. Preserving Virginia's Competitive Economic Position -- These findings relate to whether Virginia would gain economic development advantages by staying out of a national, mandatory program, assuming such program contained an "opt-out" provision.
5. Important Unknowns About SSUTA -- These findings list the factors surrounding SSUTA that are still unknown, such as the additional cost of collection on vendors, and the amount of additional sales taxes that would be paid by Virginia consumers.

Mr. DelBianco's suggested recommendations include the following:

1. Virginia should continue to monitor and influence the SSUTA debate through its multiple roles—as a Participating State in the Streamlined Sales Tax Project, Governor Warner's chairmanship of the National Governors Association, and many Virginia Legislators who participate in the National Conference of State Legislatures, including Senator Hanger's leadership on NCSL's task force on remote sales taxation.
2. Virginia should continue to monitor and influence the SSUTA debate through its multiple roles—as a Participating State in the Streamlined Sales Tax Project, Governor Warner's chairmanship of the National Governors Association, and many Virginia Legislators who participate in the National Conference of State Legislatures, including Senator Hanger's leadership on NCSL's task force on remote sales taxation. Virginia representatives to these organizations should advance the Commonwealth's interest in the SSUTA and in federal legislation by advocating policies beneficial to the Commonwealth such as:
  - (i) origin-based sourcing on all sales, with no discrimination between online and offline retailers or between interstate and intrastate commerce;
  - (ii) a broad prohibition against taxation of electronically delivered services, software downloads, online content, and Internet access services;
  - (iii) compensation for all retailers to cover substantially all reasonable costs of collection as a condition of any state's participation;

(iv) explicit protections against multiple sales tax audits;

(v) changes to federal SSUTA legislation *to allow a voluntary interstate tax collection compact instead of a national mandate* in order to protect Virginia's tax sovereignty and ability to compete for economic development prospects.

3. Because of too many unknowns surrounding SSUTA, including whether Virginia would be a net gainer or loser, Virginia's General Assembly should not consider adoption of SSUTA in its 2004-2005 legislative session.

There was a brief discussion by the Joint Subcommittee of Mr. DelBianco's proposals. It was agreed that the final proposal should also recommend that the Virginia Department of Taxation also study the fiscal impact on localities that would result under a destination-based sourcing rule. There was consensus that Mr. DelBianco's proposal would be one of the working documents from which the Joint Subcommittee will develop its final proposals at the next meeting.

### **Next Meeting**

The members will be polled for the date of the next meeting of the joint subcommittee, which will occur sometime in the last two weeks of November. The meeting date will be posted once it has been established.