



Streamlined Sales Tax Project

DRAFT ISSUE PAPERS AND PROPOSALS NO. 2

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The Streamlined Sales Tax Project has prepared Issue Papers to explain in more detail the provisions of the proposals approved by the Project in December, 2000 (amended January, 2001.) In some instances, the draft proposals contain alternative positions. This document will be discussed at the Project meeting in Minneapolis, MN in August 2001.

Table of Contents

	Page
I. Tangible Personal Property, Digital Products and Software	1
II. Drug	8
III. Medical Equipment.....	12
IV. Multiple Tax Rates/Multiple Tax Bases.....	15

I. Tangible Personal Property, Digital Products and Software

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STREAMLINED SALES TAX PROJECT

TANGIBLE PERSONAL PROPERTY, DIGITAL PRODUCTS, AND SOFTWARE ISSUE PAPER

Issue:

The subgroup on tangible personal property, digital products, and software was assigned the task of developing definitions for those terms. In the course of its work, the subgroup held meetings in New Orleans, Milwaukee, and Raleigh. Interested persons from the private sector participated in these meetings along with the government representatives. Additionally, government representatives had several teleconferences and numerous e-mail exchanges. Many divergent points of view were expressed during the meetings and teleconferences, making consensus difficult to achieve. Consequently, several alternatives are presented in this report.

Tangible personal property:

The first alternative proposed as a definition of tangible personal property is:

“Tangible personal property” means personal property that can be seen, weighed, measured, felt or touched, or that is in any other manner perceptible to the senses. Tangible personal property includes electricity, water, gas, and steam. Tangible personal property does not include real property or intangible property.¹

¹ This language mirrors the definition adopted by the Tax Base Workgroup in November of 2000, except that the subgroup recommends that the term “canned software,” which originally followed the word “steam,” be excluded from the definition. The subgroup decided not to craft a definition for the term “canned software,” opting instead to recommend a definition for all software, with a

Nineteen states already use this or similar language to define tangible personal property for sales tax purposes.

The inclusiveness of “tangible personal property” was a major item of discussion for the subgroup, with the largest issue being whether digital products should be included within the definition of tangible personal property. The following arguments in favor of inclusion were presented:

1. Digital products are in fact tangible personal property.
2. This concept is explained in *South Central Bell v. Barthelemy*, 643 So.2d 1240 (La. 1994), a Louisiana Supreme Court case. The case dealt with the application of use tax to software delivered both on magnetic tape and over telephone lines. The court said that software was not intangible, not mere knowledge or intelligence. It was, “knowledge recorded in a physical form which has physical existence, takes up space on the tape, disc, or hard drive, makes physical things happen, and can be perceived by the senses.” The court said that software is inextricably intertwined with the object upon which it is recorded and that the software must be in physical form on some tangible object in order to be used.
3. While the case dealt only with software, the ideas expressed apply equally to other digital products.
4. Digital products are the functional equivalent of tangible personal property and should be treated no differently. Buying a book at a bookstore and buying the same book delivered electronically should have the same tax consequences. Equal treatment would help to even the playing field. This argument would only apply to a narrow definition of digital products.
5. Nine states (Connecticut, Idaho, Indiana, Louisiana, Missouri, South Dakota, Texas, Utah, and Washington) currently tax digital products. Of these, five states (Idaho, Louisiana, Missouri, Texas, and Washington) appear to tax them on the theory that they are tangible personal property.*

Reasons expressed why digital products should not be included within the definition of tangible personal property:

breakout category for custom software. However, it should be noted that all of the 28 states responding to the subgroup’s March 30, 2001 survey stated that they currently consider canned software sold on mediums such as diskettes or CD-Roms to be tangible personal property.

* This information was derived from a survey on software and digitized products sent March 30, 2001, to states active in the Streamlined Sales Tax Project. Twenty-eight states responded to the survey.

1. It can be difficult to conceptualize digital products as tangible personal property. There are cases and statutes that say they are not tangible personal property.
2. Including digital products within the definition of tangible personal property could be viewed as an expansion of the tax base.
3. Fourteen states (Arkansas, California, Georgia, Illinois, Iowa, Kansas, Michigan, Minnesota, New Jersey, Pennsylvania, Rhode Island, South Carolina, Vermont, and Wisconsin) currently do not tax digital products. Of these, ten states (Arkansas, California, Georgia, Illinois, Kansas, Michigan, Minnesota, New Jersey, Vermont, and Wisconsin) appear to exempt them on the theory that they are not tangible personal property.*

On balance, the subgroup felt that digital products should not be included within tangible personal property and that this term should be separately defined. States would decide if sales of these items would be subject to the sales tax within their particular jurisdiction.

Should the Project choose to include digital products within the definition, the second alternative proposed as a definition of tangible personal property is:

“Tangible personal property” means personal property that can be seen, weighed, measured, felt or touched, or that is in any other manner perceptible to the senses. Tangible personal property includes digital products, electricity, water, gas, and steam. Tangible personal property does not include real property or intangible property.

The subgroup also considered whether electricity, water, gas, and steam should be specifically itemized as tangible personal property. The subgroup felt that these items should be included within the definition of tangible personal property to avoid creating ambiguity. Representatives from states that currently include these items in their definition of tangible personal property expressed concern that the exclusion of these items would allow courts to conclude that they are no longer tangible personal property. States not currently taxing electricity, gas, water, and steam could specifically exempt these items.

*

This information was derived from a survey on software and digitized products sent March 30, 2001, to states active in the Streamlined Sales Tax Project. Twenty-eight states responded to the survey.

Digital products:

The term “digital product” or “digital property” is not defined in the sales tax statutes of the 28 states that responded to the subgroup’s survey. Due to this lack of current statutory guidance, the subgroup examined both narrow and broad definitions for digital products. The narrow definitions that are suggested below incorporate only those products that have a tangible counterpart. A concern expressed about the use of a narrow definition is that some items that now have a tangible counterpart, such as software, may not have a tangible counterpart in the future. Conversely, the broad definitions suggested by the subgroup encompass all items expressed in an electronic or similar format.

The narrow definition proposed at the Raleigh meeting was:

“Digital product” means a product that is delivered electronically and would be taxable if delivered on a CD, diskette, or in another tangible form.

Members of the subgroup had reservations about the use of the word “taxable” because decisions about taxability should be separate from the definition of an item. Additionally, this definition may not promote uniformity because what is taxable varies from state to state. Because of these concerns, the subgroup recommends another narrow definition for consideration, which deletes any reference to taxability:

“Digital product” means a product that is delivered electronically and that has a tangible counterpart.

In looking at broad definitions, the subgroup considered the Uniform Computer Information Transactions Act (UCITA) as a resource. The UCITA was promulgated in 2000 by the National Conference of Commissioners on Uniform State Laws (NCCUSL). It applies to transactions involving computer information in the same way that Article 2 of the Uniform Commercial Code (UCC) applies to transactions involving goods. To date, Maryland and Virginia have adopted the UCITA and it has been introduced in eight other states. The subgroup does not intend that the operative provisions or judicial constructions of the UCITA necessarily apply to the administration of sales tax. However, UCITA definitions can be very useful, as they appear to be neutral, comprehensive, and technically accurate.

The subgroup submits a recommendation for a broad definition of digital product, which is based in large part on the UCITA definition of “computer information”:

“Digital product” means a product (data, text, images, sounds, mask works, or computer programs and their equivalents, including collections and compilations of them) in electronic form which is obtained from or through the use of a computer

or which is in a form capable of being processed by a computer. The term includes a copy of the product and any documentation or packaging associated with the copy.

Copy is defined in the UCITA as:

“Copy” means the medium on which information is fixed on a temporary or permanent basis and from which it can be perceived, reproduced, used or communicated, either directly or with the aid of a machine or device.

A final recommendation in this area involves patterning the definition of digital goods upon the definition of intangible property. This recommendation also uses the term “digital property” instead of “digital products,” which would keep this definition consistent with “tangible property” and “intangible property.”

“Digital property” means personal property that is delivered without the transfer of an intermediate storage medium. Examples of digital property include software, music and video, whether in digital or analog form. Examples of intermediate storage media include films, tapes, records, and magnetic or optical disks.

Software:

The first proposed definition of software is:

“Software” means a set of coded instructions designed to cause a computer, another electronic device, or automatic data processing equipment to perform a task.

A second definition of software, not found in the UCITA but designed to work with UCITA definitions, is:

“Software” means an organized and interrelated set of one or more computer programs, which may include documentation and examples that describe how the software may be tailored and used for specific applications.

UCITA definitions that would accompany this definition of software include:

“Computer” means an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions.

“Computer program” means a set of statements or instructions to be used directly or indirectly in a computer to bring about a certain result. The term does not include separately identifiable informational content.

“Electronic” means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

The subgroup decided not to define canned software. Instead, the broad category of software would include those products traditionally defined under canned software. States choosing to tax canned, but not custom and/or modified, software, could impose tax on the general classification of software and then exempt custom and/or modified software.

Several definitions were proposed:

“Custom software” means software that has been designed and produced exclusively for a specific identifiable customer.

“Custom software” means software that is designed for a specific user where the cost of prewritten software is no more than ten percent [or other appropriate figure] of the sales price.

“Modified software” means software that has been changed for a specific user to the extent the charges for the changes are separately stated.

Other issues:

The subgroup believes that there should be a definition for information services, which would include individualized information services, general information services, database access, advertising services, and interactive entertainment. States would then have the opportunity to treat information services differently than other digital products.

The subgroup suggests that the Lease and Rental Subgroup look at the UCITA definitions in the course of its work. In particular, the UCITA definition of license may prove helpful since licensing is typically the way software is provided to customers. The UCITA definition of license is:

“License” means a contract that authorizes access to, or use, distribution, performance, modification, or reproduction of, information or informational rights, but expressly limits the

access or uses authorized or expressly grants fewer than all rights in the information, whether or not the transferee has title to a licensed copy. The term includes an access contract, a lease of a computer program, and a consignment of a copy. The term does not include a reservation or creation of a security interest to the extent the interest is governed by [Article 9 of the Uniform Commercial Code].

Summary:

- The subgroup, because of the difficulty of achieving consensus, has presented several options for each of the terms assigned.
- The subgroup favors the concept of excluding digital products from the definition of tangible personal property.
- The subgroup recommends that definitions of different information services be developed.

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STREAMLINED SALES TAX PROJECT

DRUG ISSUE PAPER

Issue:

To develop a uniform definition of "drug" that is acceptable to both state government and industry while simplifying compliance with tax law.

Background:

The Tax Base workgroup of the Streamlined Sales Tax Project has the goal of providing uniform definitions of selected terms for the new sales tax system. The purpose is to ease the burden on those involved in interstate commerce by minimizing the complexities inherent in the current system. The group intends to develop definitions that will allow all states to support and adopt a new system.

To achieve this streamlining, the group proposes to develop uniform definitions without making determinations about the taxability of items when possible. Uniform definitions would lay the groundwork for further uniformity and simplification while giving each state the flexibility they will need for implementation. This approach should also minimize some difficulties anticipated with transition to a new system.

Discussion:

From a review of states tax laws, all states with the exception of Illinois allow either an exemption for prescription drugs or drugs sold pursuant to a

prescription. Illinois taxes drugs at a reduced rate. Ten states and the District of Columbia also having an exemption for nonprescription drugs.

Based on this finding, it was determined that a standardized definition would be required for drug and one for prescription, with each state utilizing either the drug definition or both in combination to replicate its existing tax law. Creating a definition for nonprescription or over-the-counter drug was considered but inclusion in unified drug definition was deemed preferable.

For the term of drug there are three approaches utilized by the states with the largest being the utilization of an exemption with no precise definition. The other two being the utilization of other state codes or the utilization of the Federal Food, Drug and Cosmetic Act definition in creating a state definition.

At first thought, the workgroup considered using the Federal Food, Drug and Cosmetic Act definition of drug thus having the past precedents established by said definition as an asset. Upon further consideration, there were concerns that lifting this one definition from the full regiment of the federal act would in itself cause past precedents to be lost.

Accordingly, a draft definition submitted by the Consumer Healthcare Products Association, which does rely heavily of the FFDCA definition, was utilized as the starting point with modifications made. The biggest of which is the limitation of nonprescription drugs for hygiene and grooming. See Alternatives for a continuation of this discussion.

Lastly, since some states allow an exemption for sales of drugs for animal use, it was decided to create a broad drug definition. Each state then would limit drugs for human use in the drafting of its exemption.

There were two additional items examined but were transferred to other Tax Base subgroups since they relate more to said subgroups. First, the handling of free samples of drugs was deemed not to be a definition question but an imposition question, so it was forwarded to that subgroup. Second, the bundling of taxable and nontaxable drug and medical equipment items is not a definition problem but a bundling problem which would be handled in the same manner as other bundled items, so it was forwarded to that subgroup.

Proposed definition:

The term “**drug**” means a compound substance or preparation (other than food):

- (a) intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease in human or other animals;
- (b) intended to affect the structure or any function of the body of human or other animals;

- (c) intended for use as a component of any article specified in clause (a) or (b);
or
- (d) the label of which identifies the product as a drug by containing as required pursuant to 21 C.F.R. §201.66 one or both of the following:
 - (1) a “Drug Facts” box found on the label or
 - (2) a statement of the “active ingredient[s]” with a list of those ingredients contained in the compound substance or preparation;
but does not include medicated items which are normally used for personal hygiene or grooming by healthy persons.

For the prescription definition, there was unanimity in current state law and in discussions in the work groups.

Proposed definition:

Prescription means an order, formula, or recipe issued in any form of oral, written, electronic, or other means of transmission by a {duly licensed practitioner} authorized by the laws of the state.

Each state can then utilize its own unique term for the health care professionals it allows as a {duly licensed practitioner} based on its need.

From these two definitions, each state can create an exemption to replicate its current law, either prescription drugs, drugs sold pursuant to a prescription or all drugs.

Effect on States:

Utilizing the proposed definitions would have limited effect.

Alternatives:

As stated in the discussion area, the nonprescription drug section was modified to exclude grooming and hygiene products from the definition due to the premise of attempting to replicate existing state laws and a concern of loss of revenue on states.

If the FDCA over-the-counter drug definition was used, see alternative definition below, a bright line would be created but items now taxable would be exempt, examples of such are anti-persperant, toothpaste and sun block.

Alternative drug definition:

The term “**drug**” means a compound substance or preparation (other than food):

- (a) intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease in human or other animals;
- (b) intended to affect the structure or any function of the body of human or other animals;
- (c) intended for use as a component of any article specified in clause (a) or (b); or
- (d) the label of which identifies the product as a drug by containing as required pursuant to 21 C.F.R. §201.66 one or both of the following:
 - (1) a “Drug Facts” box found on the label or
 - (2) a statement of the “active ingredient[s]” with a list of those ingredients contained in the compound substance or preparation.

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STREAMLINED SALES TAX PROJECT

MEDICAL EQUIPMENT ISSUE PAPER

Issue:

To examine state laws for medical equipment and develop a uniform definition that is acceptable to both state government and industry while simplifying compliance with tax law.

Background:

The Tax Base workgroup of the Streamlined Sales Tax Project has the goal of providing uniform definitions of selected terms for the new sales tax system. The purpose is to ease the burden on those involved in interstate commerce by minimizing the complexities inherent in the current system. The group intends to develop definitions that will allow all states to support and adopt a new system.

To achieve this streamlining, the group proposes to develop uniform definitions without making determinations about the taxability of items when possible. Uniform definitions would lay the groundwork for further uniformity and simplification while giving each state the flexibility they will need for implementation. This approach should also minimize some difficulties anticipated with transition to a new system.

Discussion:

Based on an initial review of state laws, it was determined there was a need to create two definitions, one being for prosthetics and the other being durable medical equipment.

For the prosthetics area, most states utilize an exemption with no precise definition with the few with definitions having no uniformity. The major question was whether to limit the definition to devices that replace a missing part of the body or to also include devices that replace a function of the body. There was also a question how this definition would interrelate with the definition of durable medical equipment. The last question revolved around the effect of Medicare or Medicaid payments on taxability.

It was decided to write a broad definition of the term 'prosthetic device' with the starting point being the definition in 42CFR440.120. Any state could then draft an exemption creating a limitation to any Medicare or Medicaid payment or reimbursement. An exemption also could be drafted to require a prescription, as previously define, as each state sees fit.

As to the term 'durable medical equipment', there were no states that create a definition of said term with some creating an exemption for durable medical equipment for home use. It was decided that the definition should be broadened by eliminating the for home use requirement, which would give a state more flexibility in utilizing the definition, but a state could require said home use as part of an exemption. An exemption also could be drafted to require a prescription, as previously define, as each state sees fit.

Proposed definitions:

Prosthetic device means a replacement, corrective, or supportive device and repair parts worn on or in the body to --

- (1) Artificially replace a missing portion of the body;
- (2) Prevent or correct physical deformity or malfunction; or
- (3) Support a weak or deformed portion of the body.

Durable medical equipment means equipment which:

- (1) Can withstand repeated use; and
- (2) Is primarily and customarily used to serve a medical purpose; and
- (3) Generally is not useful to a person in the absence of illness or injury; and
- (4) Any repair and replacement parts for same.

Based on these definitions, it was determined that a definition would be required for mobility aids since they do not fall within either of these definitions.

Effect on States:

The prosthetic device definition as drafted would include but not be limited to hearing aids and batteries, corrective eyeglasses, contact lenses, orthotics and dentures that have a disparate handling by states. Accordingly, there would be a corresponding loss of revenue if a state currently exempts prosthetics devices but taxes these or like items.

The durable medical equipment definition as drafted now includes repair and replacement parts, which could cause a state revenue loss depending on current treatment. With the inclusion of a home use requirement in an exemption, there should be no revenue effect.

Alternatives:

As stated in the discussion area, one alternative for prosthetic devices was to limit the definition to replace a missing part. It was decided to include both missing body part and missing body function in order allow for current state policies and to create the brightest line.

IV. Multiple Tax Rates/Multiple Tax Bases

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STREAMLINED SALES TAX PROJECT

MULTIPLE TAX RATES/MULTIPLE TAX BASES ISSUE PAPER

Issue:

The number of jurisdictions with the ability to levy sales and use taxes, the frequency and timing of rate changes, difficulties in knowing district boundaries and keeping up with boundary changes, and problems with accurately assigning the appropriate jurisdictions to a specific location make the administration of tax rates difficult for all involved. This paper will cover the following three areas related to the administration of sales and use taxes. These are:

- 1) Separate tax rates for individual local jurisdictions;
- 2) Separate tax rates for different goods or services within a state or local jurisdiction; and,
- 3) Multiple tax bases within a state.

The rate and base issues have been combined because the problems they create for retailers are similar and the two issues often overlap.

Background:

The most significant issues faced by retailers in complying with state and local sales and use tax levies can be summarized as follows: (1) knowing what rates are in effect at any given time, location and for each product sold; (2) being able to easily apply the rates at the time of a transaction in a variety of retail settings (over-the-counter sales, internet sales, catalog sales etc.); and (3) liability for tax, penalties and interest when the retailer is unable to accurately collect the tax because of difficulty in assigning the correct rate.

How should the Streamlined Sales Tax Project proceed with their efforts to simplify and streamline multiple tax rates currently assessed by the participating states and their local jurisdictions? To address this question we first look to the specific problems that the current tax structure has created. To identify these problems we asked the vendors who have to work within the current tax structure to provide issues that they have in complying with the our tax laws. Industry provided the workgroup with the following major issues.

Issues identified in discussions with retailers

- Difficulty in obtaining correct tax rates for local jurisdictions
- Keeping up with tax rate changes
- Liability for tax, penalties and interest for incorrect application of rates
- Potential liability from taxpayer lawsuits for overcharges
- Time needed to incorporate changes into billing and rate calculation systems
- No uniform coding system for identifying tax jurisdictions
- Difficulty in assigning appropriate tax rate at the time of the transaction
- Identifying tax jurisdiction boundaries
- Keeping up with boundary changes
- Incorporating boundary changes into rate calculation/billing systems
- Different rates charged in some states jurisdictions for different products
- Requirements in some states regarding the use of tax rate brackets

Among the concerns raised were the amount of lead-time provided by the states for changes in rates as well as the number of rates of allowed. This was a concern of the catalog vendors. They are proposing a single rate per state with a six-month lead-time on changes to rates to coincide with catalog publishing.

The vending industry voiced concerns about not allowing more than one taxing methodology for any given taxing jurisdiction. Their problem is that the taxation of coin-operated vending machines is typically treated differently from the other taxable transactions. In some states the product sold in not taxed at all and the machines are charged an annual fee. In other states the tax is assessed on the product but is taxed at a different rate.

One business representative voiced a concern relating to when a tax would be considered due if shipping of the item would not occur for several weeks. If the rate were to change after the sale and before the delivery would the tax be

collected based on the old rate or the new rate? This concern was shared by the telecommunications industry.

The Streamlined Sales and Use Tax Agreement (Agreement) as approved on December 22, 2000 and amended on January 24, 2001 restricts the number of rates charged at the state level to a single rate. It also restricts local jurisdictions to a single rate per jurisdiction.

This Agreement was adopted after numerous public meetings involving the states and representatives of industry and the public. Testimony was taken from the retail, manufacturing, and telecommunications industries, catalog vendors, representatives of the coin operated vending industry as well as vendors of technological solutions to sales and use taxation.

It is important to note that varying rates charged by jurisdictional boundaries can be treated separately from rates that vary by product. The steps taken to restrict the number of rates allowed in the agreement are limited to the restriction of rates on products and services not on jurisdictional boundaries. The agreement allows for a single rate for each taxing jurisdiction to be administered through the use of technology and data provided by the states. The agreement also places restrictions on the timing of changes to the rates within a jurisdiction and to the changing of jurisdictional boundaries.

Separate Tax Rates for Individual Local Jurisdictions

There are approximately 7,500 jurisdictions with existing sales tax levies and many more that have the authority to adopt such levies. There are 12 states with a single sales and use tax rate. An additional 6 states have a single use tax rate and multiple sales tax rates. This leaves 29 states with multiple tax rates by jurisdiction (see Table 1).

TABLE 1

Sales and Use Tax Rates- Multiple Jurisdictional Rates

Characteristics	# of Sts.	Total	States
No local option sales and use taxes (single sales/use tax rate)	10	10	Connecticut, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Jersey, Rhode Island, West Virginia
Allow local option sales and use taxes (single rate).	2	12	District of Columbia, Hawaii

Allow local option sales tax (multiple rates). No local option use tax (single rate).	6	18	Idaho, Illinois, Iowa, Kansas, New Mexico, Vermont
Allow local option sales and use taxes (multiple rates).	29	47	Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida, Georgia, Louisiana, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, Wyoming

Discussion:

There were several alternatives discussed during the meetings of the workgroup over the last year. Of these alternatives two were looked at in depth. They were:

1. One rate per state.
2. One rate per state for certain transactions

One Rate Per State— In evaluating the option of allowing only a single sales and use tax rate per state, the work group reached the following conclusions:

- Local option sales and use taxes are a very important component of many states' fiscal systems and it would be very difficult to fundamentally change this structure.
- Local governments provide many critical services and in many states the trend is toward increased reliance on sales and use taxes to fund these services.
- While this proposal sounds like a “simple” solution to the rate issue, for many states it creates a multitude of political, administrative and revenue issues that will be extremely difficult to resolve. Such as what rate to set, how to allocate funds to local jurisdictions, and what to do about local taxes that are dedicated to the repayment of bonds.

One Rate Per State for Certain Transactions - An alternative to the one rate per state proposal is to allow local option taxes for most sales and to treat remote

sales as a separate category. These would be sales for which local rates create additional problems (either because of administrative difficulties in determining whether the tax is due, how much is due, and where it is to be sent, or because of legal difficulties in enforcing the collection of taxes that are due). There are two options proposed for imposing a single rate for certain transactions.

1. Apply a single use tax rate for vendors that do not have nexus in any given state.
2. Apply a single use tax rate to “remote sales” while still allowing local option sales tax rates for “in state sales”.

There are many administrative, legal and revenue issues associated with either of these alternatives. These issues are discussed at length in the report previously presented by the work group.

SSTP Agreement Language Related to Rates for Jurisdictions

The following is the language from the SSTP Agreement that is related to rates for individual taxing jurisdictions.

308 STATE AND LOCAL TAX LEVIES

- a. To reduce the complexity and administrative burden of collecting sales and use taxes, all member states must:
 1. Lessen the difficulties faced by sellers when there is a change in a state sales or use tax rate or base by making a reasonable effort to do all of the following:
 - a. Provide sellers with as much advance notice as practicable of a rate change.
 - b. Limit the effective date of a rate change to the first day of a calendar quarter.
 - c. Notify sellers of legislative changes in the tax base and amendments to sales and use tax rules and regulations.
Failure of a seller to receive notice or failure of a State to provide notice or limit the effective date of a rate change shall not relieve the seller of its obligation to collect sales or use taxes for that member state.
 2. Provide that the effective date of rate changes for services covering a period starting before and ending after the statutory effective date shall be as follows:
 - a. For a rate increase, the new rate shall apply to the first billing period starting on or after the effective date.
 - b. For a rate decrease, the new rate shall apply to bills rendered on or after the effective date.

b. Member states that have local jurisdictions that levy a sales or use tax must:

1. Not have more than one sales tax rate or more than one use tax rate per local taxing jurisdiction. If the local jurisdiction levies both a sales tax and a use tax, the rates must be identical.
2. Not place caps or thresholds on the application of local sales or use tax rates or exemptions that are based on the value of the transaction or item.
3. Provide that local rate changes will be effective only on the first day of a calendar quarter after a minimum of sixty (60) days' notice to sellers.
4. Apply local sales tax rate changes to purchases from printed catalogs wherein the purchaser computed the tax based upon local tax rates published in the catalog only on the first day of a calendar quarter after a minimum of 120 days notice to sellers.
5. For sales and use tax purposes only, apply local jurisdiction boundary changes only on the first day of a calendar quarter after a minimum of sixty (60) days notice to sellers.
6. Provide and maintain a database that describes boundary changes for all taxing jurisdictions. This database must include a description of the change and the effective date of the change for sales and use tax purposes.
7. Provide and maintain a database of all sales and use tax rates for all of the jurisdictions levying taxes within the State. For the identification of states, counties, cities, and parishes, codes corresponding to the rates must be provided according to Federal Information Processing Standards (FIPS) as developed by the National Institute of Standards and Technology. For the identification of all other jurisdictions, codes corresponding to the rates must be in the format determined jointly by the member states.
8. Provide and maintain a database that assigns each five (5) digit and nine (9) digit zip code within the State to the proper tax rates and jurisdictions. The State must apply the lowest combined tax rate imposed in the zip code area within the state if the area includes more than one tax rate in any level of taxing jurisdiction. If a nine (9) digit zip code designation is not available for a street address or if a seller is unable to determine the nine (9) digit zip code designation of a purchaser after exercising due diligence to determine the designation, the seller may apply the rate for the five (5) digit zip code area. For the purposes of this section, there is a rebuttable presumption that a seller has exercised due diligence if the seller has attempted to determine the nine (9) digit zip code designation by utilizing

software approved by the member states that makes this designation from the street address and the five (5) digit zip code of the purchaser.

9. Participate with other member states in the development of an address-based system for assigning taxing jurisdictions. The system must meet the requirements developed pursuant to the federal Mobile Telecommunications Sourcing Act, at 4 U.S.C.A. § 119. At a future date, member states acting jointly may allow a member state to require sellers registered under this agreement to use an address-based system provided by that member state. If any State develops an address-based assignment system pursuant to the Mobile Telecommunications Sourcing Act, a seller may use that system in place of the system provided for in paragraph 8 of this section.
10. The provisions of paragraphs (1) and (2) of this subsection do not apply to sales or use taxes levied on the transfer of motor vehicles, aircraft, watercraft, modular homes, manufactured homes or mobile homes.

Separate Tax Rates for Individual Goods or Services

In addition to rates that vary by jurisdiction, some states and local jurisdictions have special rates for different products or use specific criteria for the application of rates. Of the 46 states that administer a state sales tax, 25 of those states charge special rates for some product category or service. The other 21 states have no special tax rates. Appendix 1 is a listing of the additional rates that are currently levied by states.

Following are the types of multiple tax rates that currently exist in the states.

- a. Multiple rates for particular categories of items.

Examples:

Missouri- a general sales tax rate of 4.225% and a 1% rate for groceries.

Illinois- a general sales tax rate of 6.25% and a 1% rate for groceries and drugs.

Florida- a general sales tax rate of 6% and 2.5% rate for sales of agricultural machinery.

Several States- a separate rate for motor vehicles, airplanes, etc. (some states charge a distinct sales tax rate while others exempt these items from the sales tax and levy a separate excise tax).

Several States- a separate rate for lodging (some states charge a distinct sales tax rate while others exempt these items from the sales tax and levy a separate tourism or lodging tax).

- b. Multiple rates for certain types of taxpayers.

Example:

South Carolina- a 5% general sales tax rate for non-food items and a 4% rate for non-food items for purchasers over 65.

- c. Different rates for purchases made in a different manner.

Example:

Several States- a different rate on sales made through vending machines. In some states the sales tax is charged at a rate that is different than the general rate. In other states vending sales are exempt from sales tax but a separate tax is charged (commonly through the purchase of an annual tax stamp).

SSTP Agreement Language Related to Multiple Rates

The following is the language from the SSTP Agreement related to the multiple tax rates.

308 STATE AND LOCAL TAX LEVIES

- a. To reduce the complexity and administrative burden of collecting sales and use taxes, all member states must:
 - 4. Not have multiple state tax rates on items of personal property or services after December 31, 2005. A State may continue to have a generally applicable state tax rate and additional state rates until that date.
 - 6. The provisions of paragraphs (3) and (4) of this subsection do not apply to sales or use taxes levied on the transfer of motor vehicles, aircraft, watercraft, modular homes, manufactured homes or mobile homes.

b. Member states that have local jurisdictions that levy a sales or use tax must:

1. Not have more than one sales tax rate or more than one use tax rate per local taxing jurisdiction. If the local jurisdiction levies both a sales tax and a use tax, the rates must be identical.
10. The provisions of paragraphs (1) and (2) of this subsection do not apply to sales or use taxes levied on the transfer of motor vehicles, aircraft, watercraft, modular homes, manufactured homes or mobile homes.

Multiple Tax Bases within a State

A related issue is that of the tax base. Retailers must know what items are taxable and what items are not taxable. Most states have a single tax base (any particular item or service is either taxable or nontaxable everywhere in the state and is taxable at both the state and local level).

The following are two ways in which the sales tax base (what is and isn't taxable) is different at the state level and the local level.

- a. When local jurisdictions can individually have a tax base that is different than the state tax base and different than other local jurisdictions. In this instance there can be numerous local tax bases within a state.

Examples:

Colorado- food for home consumption, as well as electricity, gas and fuel oil for residential use are not taxed at the state level but may be taxed by local jurisdictions at their option.

Louisiana- for repairs to out-of-state customers a local jurisdiction has the option of imposing the sales tax. Also, with legislative and voter approval, some local jurisdictions have exempted groceries and drugs from the sales tax.

- b. When the state has statutorily established a local sales tax base that is different from the state tax base. Under this circumstance, a state would have two tax bases (a single state base and a single local base).

Examples:

North Carolina- groceries are exempt from the state sales tax but are subject to local sales tax.

Oklahoma- sales of residential electricity are taxed at the local level and not the state level.

Louisiana- drugs and medical supplies are taxed in most local jurisdictions but not at the state level. Also, telecommunications services are taxed at the state level and not the local level.

Several States- direct-to-home satellite services are taxed at the state level and not at the local level (federal law prohibits local tax).

SSTP Agreement Language Related to Tax Base

The following is the language from the SSTP Agreement related to tax base.

304 STATE AND LOCAL TAX BASES

- a. Through December 31, 2005, if a member state has local jurisdictions that levy a sales or use tax, all local jurisdictions in the State must have a common tax base. After December 31, 2005, the tax base for local jurisdictions must be identical to the state tax base, unless federal law prohibits the local jurisdictions from taxing a transaction taxed by the State.
- b. This section does not apply to sales or use taxes levied on the transfer of motor vehicles, aircraft, watercraft, modular homes, manufactured homes or mobile homes.

Appendix 1

States' General Sales Tax Rate and Special Rates

State	Base Rate	Special Rates
Alabama	4%	3% for sales from vending machines 2% for sales of vehicles and manufactured homes 1.5% for sales of manufacturing machinery
Alaska		No State Sales Tax
Arizona	5%	3.125% for sales of non-metal mining machinery
Arkansas	5.13%	3% on sales thru vending machines 1% on short term rentals 1.5% on long-term rentals of vehicles 4.5% on residential moving services Other miscellaneous rates
California	5.75%	No special rates
Colorado	2.90%	No special rates
Connecticut	6%	12% for sales of hotel rooms 4.5% for sales of motor vehicles to active military 5.75% for the sale of patient care services 2% for sales of computer and dp services
Delaware		No Sales Tax
District of Columbia	5.75%	8% for sales of off premises liquor 10% for restaurant meals and liquor on premises 10% for vehicle rentals 12% for parking sales 15% for sales of lodging
Florida	6%	2.5% for sales of agricultural machinery 4% for sales of amusement machines 4% for sales of long distance incoming calls
Georgia	4%	No special rates
Hawaii	4%	No special rates
Idaho	5%	No special rates
Illinois	6.25%	1% for sales of food and drugs
Indiana	5%	No special rates

Iowa	5%	No special rates
Kansas	4.90%	
Kentucky	6%	No special rates
Louisiana	4%	3% for sales of telecommunications
Maine	5%	7% for restaurant meals if establishment is licensed for liquor sales. 7% for sales of lodging 10% for short term auto rentals
Maryland	5%	11.5% for short term auto rentals
Massachusetts	5%	No special rates
Michigan	6%	4% for sales of residential use of electricity, natural or artificial gas, or home heating fuels
Minnesota	6.50%	9% for sales of liquor 12.7% on vehicle rentals
Mississippi	7%	13 different special rates
Missouri	4.225%	1.225% for sales of food
Montana		No Sales Tax
Nebraska	5%	No special rates
Nevada	6.50%	2% for sales of prescription eyeglasses 2% for sales of agricultural machinery 4.5% for casual sales of vehicles
New Hampshire		No sales tax
New Jersey	6%	No special rates
New Mexico	5%	4.25% for sales of interstate telecommunications
New York	4%	No special rates
North Carolina	4%	2% for sales of manufactured homes 3% for sales of airplanes and boats 1% for sales of fuel and machinery to farms, mills and laundries. Various rates for sales to utilities
North Dakota	5%	7% for sales of alcohol 3% for sales of new farm machinery 1.5% for sales of used farm mach. and repair parts 3% for sales of new manufactured homes 2% for sales of natural gas 8% for short term motor vehicle rentals

Ohio	5%	No special rates
Oklahoma	4.50%	No special rates
Oregon		No Sales Tax
Pennsylvania	6%	No special rates
Rhode Island	7%	No special rates
South Carolina	5%	4% on sales of food 4% for sales to persons 85 or older 3% for sales of food to persons 85 or older 7% on rentals of accommodations 5% on "additional guest charges" at places furnishing accommodations 10% on 900/976 telephone services
South Dakota	4%	3% on sales of agricultural machinery 3% on sales of irrigation equipment 1% seasonal tax on sales of lodging, campgrounds, motor vehicle rentals, and other visitor-intensive businesses
Tennessee	6%	1.5% for sales of utilities and items consumed in the direct process of manufacturing. 3.5% for interstate telecom sales to business 8.25% for cable TV sales \$15.01 to \$27.50 8.25% for satellite TV sales 3% for sales of manufactured homes
Texas	6.25%	No special rates
Utah	5%	2% for sales of residential fuels
Vermont	5%	No special rates
Virginia	4.50%	4% for sales of food
Washington	6.50%	No special rates
West Virginia	6%	3% for sales of mobile homes
Wisconsin	5%	No special rates
Wyoming	4%	3% for sales of farm implements