

- For Information
- For Discussion
- For Decision Making

BOARD OF GOVERNANCE
INFORMAL ISSUE PAPER

Streamlined Sales and Use Tax Agreement (SSUTA)

***Proposal 7 – Motion to Amend Section 317 to Add Paragraph (A)(8)
Administration of Exemptions***

I. Issue

Should the Board of Governance grant authority to its representative to vote on the motion to amend SSUTA Section 317 to add paragraph (A)(8), as proposed by Mr. Stephen Kranz of Washington D. C.?

Should the Board of Governance vote to amend Section 317 to add paragraph (A)(8), to allow third party vendors (drop shippers) to accept a resale certificate from the purchaser/reseller regardless of whether the purchaser/reseller is voluntarily registered or has nexus in the state where the delivery and use of the product will occur? (Exhibit 1 provides the language of Section 317, including the proposed revisions. Exhibit 2 provides the motion.)

II. Staff Recommendation

Staff recommends the Board of Governance authorize its representative to vote on the motion to amend SSUTA Section 317 to add paragraph (A)(8).

Staff also recommends the Board of Governance vote “no” on the motion to amend Section 317 to add paragraph (A)(8).

III. Background

Under the SSUTA, a drop shipment is a sale in which the seller accepts an order from a customer, places the order with a third party vendor, and directs the third party vendor to deliver the item directly to the customer. If the seller (purchaser/reseller) has nexus or is voluntarily registered in the state where the sale and/or delivery occurs, the transaction is handled in the same manner as other resale transactions occurring in the state; i.e., the third party vendor may accept a resale certificate from the purchaser/reseller. If neither the purchaser/reseller or the third party vendor have nexus or are voluntarily registered in the state, the customer is generally liable for reporting and paying any taxes due on the transaction.

Proposal 7

Amend Section 317 to add (A)(8)

However, when the purchaser/reseller does *not* have nexus and is *not* voluntarily registered in the state where the delivery and use of the product occurs, but the third party vendor (drop shipper) has nexus or is voluntarily registered in the state, tax liability and/or collection issues occur. These liability and collection issues create a significant conformance dilemma for many member states, including California.

When a California retailer (third party vendor) drop ships products to a California customer on behalf of an out-of-state purchaser/reseller not voluntarily registered in California and without nexus, the California third party vendor must report and pay tax measured by the retail selling price of the property paid by the California customer. The liability for the tax is not shifted to the California customer or out-of-state purchaser/reseller.

When an out-of-state seller (third party vendor) drop ships products to a California customer on behalf of an out-of-state purchaser/reseller not voluntarily registered in California and without nexus, the California customer who will use the product in California is ultimately liable for the tax due on the transaction. However, when the third party vendor is registered in California or has nexus, the third party vendor is required to report and collect the tax from the customer and pay it to the Board of Equalization (Board).

If California were to conform to the SSUTA, when a third party vendor registered in California or with nexus, drop ships products to California customers on behalf of an out-of-state purchaser/reseller voluntarily registered under the SSUTA, the purchaser/reseller will be required to remit the taxes to the Board. An out-of-state purchaser/reseller registered under the SSUTA may properly issue a resale certificate to the third party vendor (drop shipper), relieving the drop shipper of its payment and collection obligations. This would limit the liability issues that arise when retailers registered in California drop ship products to California customers on behalf of purchasers/resellers not registered in California. It would also lessen the collection burdens of the state when neither the drop shipper or the purchaser/reseller have nexus or are registered in California since SSUTA registered sellers will be required to collect any taxes due from the customer on behalf of the Board.

Unfortunately, not all sellers will voluntarily register under the SSUTA. Extending the provisions of the SSUTA to out-of-state sellers who do not voluntarily register under the SSUTA will not resolve the tax liability issues or tax collection burdens that will exist in California if unregistered purchaser/resellers and those without nexus are permitted to purchase products without the payment of tax. The SSUTA should include provisions to address drop shipment sales involving out-of-state purchaser/resellers that do not register under the SSUTA, or the Streamlined Sales Tax Project should allow member states to have separate provisions for these types of transactions.

IV. Summary

Amending SSUTA Section 317 to add paragraph (A)(8) would create additional tax liability and collection issues for California. Additionally, the proposed amendment is inconsistent with California's current laws and policies. California's tax laws do not provide for a shift of liability from the California retailer to the customer when the customer is *not* the person who issued the resale/exemption certificate. The Streamlined Sales Tax Project should continue to discuss the issue and consider other options.

For the reasons stated above, staff recommends a "no" vote on the proposed amendment.

Prepared by Lynda Cardwell, Sales and Use Tax Department
Current as of March 28, 2005

Section 317: ADMINISTRATION OF EXEMPTIONS

- A. Each member state shall observe the following provisions when a purchaser claims an exemption:
1. The seller shall obtain identifying information of the purchaser and the reason for claiming a tax exemption at the time of the purchase as determined by the governing board.
 2. A purchaser is not required to provide a signature to claim an exemption from tax unless a paper exemption certificate is used.
 3. The seller shall use the standard form for claiming an exemption electronically as adopted by the governing board.
 4. The seller shall obtain the same information for proof of a claimed exemption regardless of the medium in which the transaction occurred.
 5. A member state may utilize a system wherein the purchaser exempt from the payment of the tax is issued an identification number that shall be presented to the seller at the time of the sale.
 6. The seller shall maintain proper records of exempt transactions and provide them to a member state when requested.
 7. A member state shall administer use-based and entity-based exemptions when practicable through a direct pay permit, an exemption certificate, or another means that does not burden sellers.
 8. After June 30, 2007, in the case of drop shipment sales, member states must allow a third party vendor (e.g., drop shipper) to claim a resale exemption based on an exemption certificate provided by its customer/re-seller or any other acceptable information available to the third party vendor evidencing qualification for a resale exemption, regardless of whether the customer/re-seller is registered to collect and remit sales and use tax in the state where the sale is sourced.
- B. Each member state shall relieve sellers that follow the requirements of this section from any tax otherwise applicable if it is determined that the purchaser improperly claimed an exemption and to hold the purchaser liable for the nonpayment of tax. This relief from liability does not apply to a seller who fraudulently fails to collect the tax or solicits purchasers to participate in the unlawful claim of an exemption.

AMENDMENT # 7 OFFERED BY STEPHEN KRANZ, WASHINGTON, D.C.

Motion to amend Section 317 to add create paragraph (A)(8) as follows:

After June 30, 2007, in the case of drop shipment sales, member states must allow a third party vendor (e.g., drop shipper) to claim a resale exemption based on an exemption certificate provided by its customer/re-seller or any other acceptable information available to the third party vendor evidencing qualification for a resale exemption, regardless of whether the customer/re-seller is registered to collect and remit sales and use tax in the state where the sale is sourced.

**STREAMLINED SALES TAX PROJECT
DROP SHIPMENTS**

PROPOSED AMENDMENTS TO SSTP AGREEMENT
February, 2005

Background

Section 317 of the Streamlined Sales and Use Tax Agreement, as amended (Administration of Exemptions), sets forth procedures a state, seller, and purchaser must follow when exemptions are claimed by a purchaser. Although not specifically provided in the Agreement, the work group dealing with exemption administration recommended allowing a seller to issue an exemption certificate for resale to the third party drop shipper, regardless of whether or not the seller is registered to collect sales or use tax in the state where the sale is sourced. In the event that the seller is not registered to collect a state's sales or use tax where the sale is sourced, the customer would report use tax on the sale, unless an exemption applies. The third party drop shipper would not be liable for tax as long as an exemption certificate or required exemption information was received from the seller. This is the common treatment by most states.

An issue paper on drop shipments was approved by the Project on May 19, 2003 (copy attached), recommending the treatment in the motion below.

MOTION

Create Paragraph A.8. in Section 317: Administration of Exemptions, as follows:

8. After June 30, 2007, in the case of drop shipment sales, member states must allow a third party vendor (e.g., drop shipper) to claim a resale exemption based on an exemption certificate provided by its customer/re-seller or any other acceptable information available to the third party vendor evidencing qualification for a resale exemption, regardless of whether the customer/re-seller is registered to collect and remit sales and use tax in the state where the sale is sourced.

On May 19, 2003, the Project approved this paper and the recommendation to allow third party suppliers to accept a resale exemption certificate from the seller regardless of whether the seller is registered to collect and remit sales and use taxes in the state when the sale is made. The Project further recommends that states be allowed additional time to get to the uniform treatment of drop shipments. After December 31, 2005, all member states will be expected to adopt the uniform treatment of drop shipments.

Streamlined Sales Tax Project
Drop Shipments Issue Paper

In discussions with the public regarding exemption processing recommendations, the question was raised as to how states would deal with drop shipments since not all the states treat them the same for sales and use tax purposes. The following is a discussion of drop shipments with a recommendation as to how they should be treated in light of public comments and recommendations for exemption processing.

What is a drop shipment?

A drop shipment is a sale in which the seller accepts an order from a customer, places the order with a third party (such as a manufacturer or wholesaler), and directs the third party to deliver the item directly to the customer. The third party may deliver the item in its own truck, arrange for delivery by common or contract carrier, or have the customer pick up the item at the third party's location.

What is the problem?

If the seller has nexus or is voluntarily registered in the state where the sale occurs, generally there is no problem. The seller collects sales or use tax on the sale of the item to the customer, unless an exemption applies. The seller purchases the item from the third party without sales or use tax because it is for resale.

If the seller **and** the third party drop shipper do not have nexus and are not voluntarily registered in the state where the sale occurs, generally there is no problem. The seller and the third party drop shipper can not be required to collect sales or use tax on the retail sale. The customer is subject to use tax on the purchase of the item, unless an exemption applies.

If the seller does not have nexus and is not voluntarily registered in the state where the sale occurs, but the third party drop shipper does have nexus or is voluntarily registered in the state where the sale occurs, there is a conflict between some states laws and the exemption processing recommendations.

Conflict with Exemption Processing Recommendations

The exemption processing recommendations would allow a seller to issue a resale certificate to the third party drop shipper, regardless of whether or not the seller is registered to collect sales or

use tax in the state where the sale occurs. The customer would report use tax on the sale, unless an exemption applies. The third party drop shipper would not be liable for tax as long as a resale certificate was received from the seller. This is the common treatment by most states.

By law, states handle drop shipments differently. The primary variations are summarized as follows (complete state summary attached):

1. The majority of states (33 out of 46) follow the exemption processing recommendation, allowing the seller to issue a resale certificate to the drop shipper, even though the seller is not registered in the state where the sale takes place. The seller is not responsible for the tax; the customer is subject to use tax.

Example

- Seller C does not have nexus in Washington and is not registered to collect Washington sales or use tax.
- Seller C receives an order from Washington Customer X for construction equipment.
- Seller C's retail selling price of the equipment is \$50,000.
- Seller C places an order to buy this equipment for \$45,000 with Third Party J, a manufacturer that has nexus in Washington and is registered to collect Washington sales tax.
- Seller C directs Third Party J to drop ship the equipment to Customer X's Washington location where the sale occurs.

The sale by Third Party J to Seller C is not subject to Washington sales or use tax because it is for resale. Customer X is subject to use tax on the \$50,000 purchase price, unless an exemption applies.

2. Thirteen states deem the third-party drop shipper the retailer of the item and require the third party drop shipper to collect sales tax on the sale to the customer or seller. Of these states, six require tax on the amount of the seller's selling price to the customer. The remaining seven states require the drop shipper to report on the wholesale price to the seller.

None of the thirteen states allow the drop shipper to accept a resale certificate from the seller unless the seller is registered in the state where the sale occurs. However, most of the states do allow the drop shipper to accept an exemption certificate if the customer can claim an exemption.

Example

- Company C does not have nexus in Wisconsin and is not registered to collect Wisconsin sales or use tax.
- Company C receives an order from Wisconsin Customer X for construction equipment.
- Company C's retail selling price of the equipment is \$50,000.
- Company C places an order to buy this equipment for \$45,000 with Third Party J, a manufacturer that has nexus in Wisconsin and is registered to collect Wisconsin sales tax.
- Company C directs Third Party J to drop ship the equipment to Customer X's Wisconsin location.

For Wisconsin (and CA, CT, HI, MA, RI), Third Party J is liable for sales tax on \$50,000 (Company C's selling price). Third Party J may not exempt the sale based on the receipt of a resale certificate from Seller C. Customer X may, if applicable, give an exemption certificate to Third Party J to exempt the sale.

For the other states (DC, FL, LA, MD, NE, NV, TN), Third Party J is required to collect sales tax from Seller C on the \$45,000 wholesale selling price. Third Party J may not exempt the sale based on the receipt of a resale certificate from Seller C's home state. In the majority of these states, Customer X may, if applicable, give an exemption certificate to Third Party J to exempt the sale.

Recommendation:

In the case of drop shipment sales, member states must allow the third party supplier to accept a resale exemption certificate from the seller regardless of whether the seller is registered to collect and remit sales and use tax in the state where the sale is made. The customer is subject to use tax if the seller does not collect the appropriate sales tax due on the sale unless the customer can claim an exemption.

If all sellers were to voluntarily register under the streamlined system, there would be no problem with drop shipments since the seller would collect tax on the retail sale to the customer and could give a resale certificate to the third party drop shipper to purchase the item without tax. Realizing that all sellers will not voluntarily register in a state where they have customers, the Work Group recommends that all states laws or regulations, whether in defining retailer, nexus, etc., be revised as a part of this project to reflect the treatment described above. It is presumed that states could identify purchasers subject to use tax based on resale exemption data received from the drop shipper, identifying those sales that are drop shipped on behalf of unregistered sellers.

Prepared by: Vicki Gibbons, Wisconsin Department of Revenue (8/2000)
Updated by: Judy Niccum, Minnesota Department of Revenue (3/2003)

Proposal 7
Amend Section 317 to add (A)(8)

Exhibit 2

(Information taken from 2000 CCH Drop Shipments Chart and 2001 SSTP Survey)

State	Resale Allowed		Tax due on customer's price	Tax due on seller's price	
	Yes	No			
Alabama	X				
Arizona	X				
Arkansas	X				
California		X	X		
Colorado	X				
Connecticut		X	X		
District of Columbia		X		X	
Florida		X		X	
Georgia	X				
Hawaii		X	X		
Idaho	X				
Illinois	X				
Indiana	X				
Iowa	X				
Kansas	X				
Kentucky	X				
Louisiana		X		X	
Maine	X				
Maryland		X		X	
Massachusetts		X	X		
Michigan	X				
Minnesota	X				
Mississippi	X				
Missouri	X				
Nebraska		X		X	
Nevada		X		X	
New Jersey	X				
New Mexico	X				
New York	X				
North Carolina	X				
North Dakota	X				
Ohio	X				
Oklahoma	X				
Pennsylvania	X				
Rhode Island		X	X		
South Carolina	X				
South Dakota	X				
Tennessee		X		X	
Texas	X				
Utah	X				
Vermont	X				
Virginia	X				
Washington	X				
West Virginia	X				
Wisconsin		X	X		
Wyoming	X				
Totals	46 states	33	13	6	7

Prepared by Judy Niccum, MN Department of Revenue (3/03)