DRAFT

Streamlined Sales Tax Project

A Report to the Legislature on the
Streamlined Sales Tax Project

Board of Governance
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Honorable Steve Westly, State Controller and Chairman, Franchise Tax Board
Honorable Roy Ashburn, California State Senate
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Honorable Rudy Bermudez, California State Assembly
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April 30, 2004

Quarterly Report to the Legislature on the Streamlined Sales Tax Project as of **March 31, 2004**

INTRODUCTION

The Streamlined Sales Tax Project (SSTP) is an 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 established in March 2000. It consists of every state that sends a representative to the SSTP meetings and participates in SSTP discussions with no voting rights ("Observer State") and every state that dedicates staff to the SSTP and regularly participates in SSTP meetings with the authority to vote on behalf of the state ("Participating State"). The work is conducted through a steering committee with co-chairs and four work groups. The SSTP's goals include: 1) simplifying the tax laws; 2) implementing more efficient administrative procedures and systems for sellers (including remote sellers) engaged in all commercial enterprises; and 3) improving technologies to substantially reduce the burden of tax collection. To accomplish these goals, each state must enact both enabling legislation and conforming legislation.

Enabling Legislation

Enabling legislation allows the state to enter into an agreement with Participating States to simplify and modernize sales and use tax administration in order to reduce the burden of tax compliance for sellers in all commercial enterprises. This does not require any amendments to a state's sales and use tax law.

Conforming Legislation

In its conforming legislation, a state will amend or modify its sales and use tax laws to achieve the simplifications and uniformity identified in the Streamlined Sales and Use Tax Agreement adopted November 12, 2002, amended November 19, 2003 (SSUT Agreement). Some states will need to make only minor revisions to their laws to implement the provisions of the SSUT Agreement. States with more complex sales and use tax laws may need to make significant revisions to their laws to implement the provisions of the SSUT Agreement.

The SSUT Agreement will become binding and take effect when at least 10 states comprising at least 20 percent of the total population, as determined by the 2000 Federal census of all states imposing a state sales tax, have petitioned for membership and have been found to be in substantial compliance with the provisions of the SSUT Agreement (i.e. enacted conforming legislation).

Authority to administer the SSUT Agreement after its effective date rests with representatives of each member state identified as the "governing board" in the SSUT Agreement (SSUT Governing Board). Each member state may appoint up to four representatives to the SSUT Governing Board. The representatives must be members of the executive or legislative branches of the state. Each member state is entitled to one vote on the SSUT Governing Board.

To date, 41 states (including California), and the District of Columbia, have passed enabling legislation. Twenty (20) states comprising 32% of the total population have passed conforming legislation. These 20 states are in the process of reviewing each state's legislation to verify that they are in substantial compliance with the SSUT Agreement. It is anticipated that the SSUT Agreement will become effective in 2005.

Status of California's Involvement in the SSTP

Since 2001, Board of Equalization (BOE) staff has monitored and evaluated the issues identified in the SSTP, including informally participating in teleconference meetings and reviewing distributed material. On March 26, 2003, the members of the BOE voted to elevate California's participation in the SSTP to an Observer State and authorized staff to take part in the SSTP meetings and discussions.

BOE staff attended their first SSTP meeting in May 2003 and has attended all subsequent meetings. BOE staff completed a preliminary review of the SSUT Agreement and continues to work on a more comprehensive analysis.

On October 8, 2003, Senate Bill 157 was signed by the Governor, making California a Participating State in the SSTP.

SENATE BILL 157

Senate Bill 157 (Chapter 702, 2003) added Chapter 1.5 (commencing with Section 6025) to Part 1 of Division 2 of the Revenue and Taxation Code.

This bill, among other things, creates a Board of Governance (BG), directs the BG to represent California as a voting member of the SSTP, and enacts certain provisions of the SSUT Agreement, as specified below.

Specifically, this bill:

1. Creates a BG consisting of two members of the Senate, chosen by the Senate Committee on Rules;[1] two members of the Assembly, chosen by the Speaker of the Assembly;[1] one member of the BOE; one member of the Franchise Tax Board (FTB); and one member of the Governor's Department of Finance.

2. Provides that the BG may represent California in all meetings attended by Participating States, authorizes the BG to vote on California's behalf at these meetings, and directs the BG to represent California's position in all matters regarding amendments to the SSUT Agreement.

3. Requires the BG to report quarterly to the Assembly and Senate Revenue and Taxation Committees on its progress in negotiating the SSUT Agreement; and directs the BG to recommend to these committees the state statutes that must be added or amended in order for California to substantially comply with the SSUT Agreement.

4. Provides that California's decision to join the SSTP shall not invalidate, amend, or otherwise modify, in whole or in part, any provision of the law of this state. The implementation of any provision of the SSUT Agreement shall be done exclusively by a separate act or acts of the Legislature.

[1] One of whom shall belong to the majority party and one of whom shall belong to the minority party.

5. Prohibits the BG from entering into the SSUT Agreement unless the SSUT Agreement requires each state to abide by certain requirements.

6. Contains the provisions that the SSUT Agreement:

   a) Is an accord among individual cooperating sovereigns in furtherance of their governmental functions, and provides a mechanism among the member states to establish and maintain a cooperative, simplified system for the application and administration of sales and use taxes under the duly adopted law of each member state;
   b) Shall bind and inure only to the benefit of this state and the other member states. No person, other than a member state, is an intended beneficiary of the SSUT Agreement. The SSUT Agreement provides that any benefit to a person other than a state is established by California law and the other member states and not by the terms of the SSUT Agreement;
   c) Provides that no person shall have any cause of action or defense under the SSUT Agreement or by virtue of California's participation in the SSTP. In addition, no person may challenge any action or inaction by any department, agency, or other instrumentality of California, or any political subdivision of California on the grounds that the action or inaction is inconsistent with the SSUT Agreement; and
   d) Provides that no California law may be declared invalid as to any person or circumstance on the grounds that the provision or application is inconsistent with the SSUT Agreement.

SSTP MEETING SCHEDULE

Several SSTP work group meetings occur every year at locations throughout the country. Additionally, work group teleconference meetings are also held. These meetings provide an opportunity to discuss revisions to the SSUT Agreement. As needed, separate meetings of Participating States are scheduled to vote on recommendations made by the work groups to revise the SSUT Agreement.

The next SSTP work group meeting is scheduled for May 24 and 25, 2004, in Tampa, Florida. The subsequent work group meeting will most likely be held in July 2004. A meeting to discuss the SSUT Agreement's general sourcing rules will be held on May 3 and 4, 2004, in Nashville, Tennessee.

PRELIMINARY ANALYSIS OF CALIFORNIA ISSUES

The following is a brief summary of some of the SSTP issues facing California. Further analysis is needed to fully understand what impact complying with the provisions of the SSUT Agreement would have on the state, local taxing jurisdictions, and California businesses. This analysis will continue to be developed and provided in future reports.

<u>Administrative Issues</u>
The SSUT Governing Board, after the effective date of the SSUT Agreement, is responsible for the administration and operation of the SSUT Agreement. The SSUT Governing Board may promulgate rules and procedures it deems necessary to carry out its responsibilities. Matters

involving the interpretation of and amendments to the SSUT Agreement will be brought before the SSUT Governing Board. The action by the SSUT Governing Board will be the final disposition of any issues.

While the California Legislature and the BOE may not be prohibited from interpreting the SSUT Agreement differently than the SSUT Governing Board, if a member state is found to be out of compliance with the SSUT Agreement, the SSUT Governing Board may expel that state from membership.

Revenue and Cost Impact

The SSUT Agreement is intended to be revenue neutral. However, complying with the provisions of the SSUT Agreement may require significant revisions to California's sales and use tax law, regulations, and administrative policies and procedures. These revisions could result in increases or decreases in both revenues and/or costs to the state. The ultimate outcome cannot be determined until a comprehensive analysis is completed.

General Sourcing Rules

In accordance with the provisions of the SSUT Agreement, local tax will be sourced (allocated) differently than currently provided for under California sales and use tax laws when the property is not delivered to the customer at the business location of the seller. This is a significant change and could negatively affect some local taxing jurisdictions.

State and Local Tax Bases

After December 31, 2005, the tax base for local jurisdictions shall be identical to the state tax base unless otherwise prohibited by federal law. This does not apply to sales or use taxes levied on the retail sale or transfer of motor vehicles, aircraft, watercraft, modular homes, manufactured homes, and mobile homes.

Currently, several partial exemptions from tax are authorized in accordance with the California sales and use tax law. These laws would need to be repealed by the specified date or revised to change each exemption from partial to full.

Monetary Allowances

States shall provide a monetary allowance to certified service providers and sellers for collecting and reporting sales and use tax. The cost impact of this provision of the SSUT Agreement has not yet been determined.

Several states (not including California) currently provide a monetary allowance to retailers for collecting and reporting sales and use tax.

SUMMARY

BOE staff is working on a comparative analysis of the SSUT Agreement. The initial emphasis will be on the general sourcing rules. The remaining sections of the SSUT Agreement will be analyzed based on a schedule being developed.

BOE staff has contacted representatives from local governments within California. They have been provided information on California's status in the SSTP and will be a vital resource when evaluating the impact of the SSTP on local governments.

Similarly, BOE staff will be contacting representatives of the business community in California in the upcoming months.