



TACIR

The Tennessee Advisory Commission
on Intergovernmental Relations



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MEMORANDUM

TO: TACIR Commission Members

FROM: Harry A. Green *Harry*
Executive Director

DATE: February 7, 2011

SUBJECT: Report on Tennessee and Streamlined Sales Tax Project

TACIR has reported on the subject of the Streamlined Sales Tax Project (SSTP) several times in the past. The presentation at the February 2011 meeting will provide a further update on the progress of the SSTP. The following items are included in the material sent to you.

1. Background material on the SSTP.
2. An update on the status of the SSTP to date.
3. A timeline on the SSTP and Tennessee's participation in it.
4. A copy of the Department of Revenue's information sheet on the Tennessee Consumer Use Tax and the Tennessee Consumer Use Tax Return.

STREAMLINE SALES TAX PROJECT BACKGROUND

In 1998, Congress passed the Internet Tax Freedom Act (ITFA). The Act successfully passed with support from Internet commerce businesses and states that had a relatively large Internet presence. The Act prohibited any new federal taxes on the Internet, placed a three-year moratorium on new state and local taxes on Internet activity (ending in October 2001), prohibited certain multiple and discriminatory taxes on Internet activity, and created the Advisory Commission on Electronic Commerce (ACEC) to study the problem of Internet taxation and regulation and to report back to Congress with recommendations for a long run policy (by mid 2000).

The Commission, which was somewhat loaded with members favoring Internet commerce and states with a large Internet presence, submitted its report in April 2000 with its recommendations. However, the Commission was unable to muster a supermajority set of recommendations as required. The “less than supermajority” recommendations that were presented to Congress generally supported a continued moratorium on any new taxation and against direct federal intervention that would assist state and local governments to collect taxes on Internet activity.

Many state and local government officials were disappointed with the final recommendations of the Advisory Commission on Electronic Commerce. They were hoping for some recognition that their responsibilities to provide essential services to their citizens were endangered by their inability to apply one of their basic tax sources to a growing dimension of household spending.

With ITFA set to expire in October 2001 and with many unresolved issues remaining, Congress chose to extend ITFA to November 1, 2003. The extension is viewed by many as a compromise between those who believe that Congress should change federal laws to help states avoid growing losses in one of their most important sources of revenue and those who believe that Congress should stay out of the E-commerce debate. The major tax prohibitions contained in the original ITFA were retained in its extension (namely a continuation of the moratorium on new Internet taxes and any multiple and discriminatory taxes on Internet commerce).

STREAMLINED SALES TAX PROJECT

Active state involvement in forging a solution to the growing sales tax loss issue began in earnest in late 1999. In December of that year, the National Conference of State Legislatures (NCSL) and the National Governors Association (NGA) joined together calling for a need for a “Streamlined Sales and Use Tax System for the 21st Century.” Model legislation crafted by the NCSL was intended to bring

states together to work on and develop a common set of procedures for collecting and administering a more simplified multi-state sales tax program. Eventually over 30 states participated in the project to develop a new streamlined sales tax system.

It was hoped that the multi-state cooperative project would be viewed as proactive, and if successful, ultimately have a two-pronged effect: it would attract some vendors not currently collecting sales taxes to voluntarily collect under a more simplified reporting and administrative system, and its creation would help sway Congress to amend federal law to require all remote vendors to collect sales taxes.¹

After detailed discussions and numerous meetings during 2000, 2001, and 2003, the project ultimately resulted in the “Streamlined Sales and Use Tax Agreement (SSUTA)”² that was approved on November 12, 2002 by 33 states and the District of Columbia. The agreement sets out the definitions and requirements that states must accept to formally enter into the multistate agreement. The final agreement reflects some compromises that were made along the way to help maximize the number of states likely to formally enter into the agreement during 2003 state legislative sessions. The agreement becomes binding and effective following its approval by at least ten states whose combined population represents at least 20 percent of the population of all sales tax states (but not before July 1, 2003). The act became effective on October 1, 2005. The presentation at the December TACIR meeting will update the ongoing workings of the SSTP and Tennessee’s participation in it.

¹ The agreement itself does not change the current situation that prevents states from requiring many remote sellers to collect sales taxes.

² Copy of “Streamlined Sales and Use Tax Agreement” is available at <http://www.streamlinedsalestax.org/index.php?page=modules>.

STREAMLINED SALES TAX PROJECT UPDATE¹

December 2010

Forty-five states (plus D.C.) impose sales or comparable gross receipts taxes. In eighteen states, local sales taxes are imposed.² Twenty sales tax states are currently full members of the SSTP. Tennessee is currently one of three associate members of the SSTP (along with Ohio and Utah).³ Tennessee is in part compliance with the SSUTA⁴ but final laws, rules, regulations, and policies that will bring Tennessee into full compliance are not currently in effect.⁵

Tennessee's associate membership is predicated on planned statutory and other changes that will become effected on July 1, 2011. Tennessee, however, has already postponed its full compliance in the past and there is no assurance that the July 2011 date won't be pushed further into the future.⁶

Major SSUTA requirements that Tennessee has already conformed to include:⁷

- Adoption of most uniform definitions such as for telecommunication services, food, healthcare, digital products, and sales tax holiday products.
- In preparation for full conformity with the SSUTA, Tennessee has registered over 90,000 farmers, nurserymen, and timber harvesters for an exemption certificate. This is expected to substantially reduce problems associated with administration of existing exemptions that benefit the agriculture industry.
- Exemption administration changes that provide sellers with reduce exposure for uncollected sales taxes in situations involving misuse of exemptions by buyers.
- Participation in the already functioning Streamlined central registration system that provides amnesty for unregistered vendors that elect to register in Tennessee. Over 350 new taxpayers (accounting for \$15 million in sales taxes) have already registered and are collecting taxes.

¹ TACIR has previously reported on this issue in 2003, 2004, and 2006.

² In Alaska, there is no states sales tax. In Virginia, the state sales tax rate of 5% includes a statewide local tax of 1%.

³ Georgia is currently awaiting acceptance as an associate member.

⁴ Streamlined Sales and Use Tax Agreement (SSUTA) spells out the many simplifications and streamlined rules and regulations that are required for full membership.

⁵ Utah and Ohio are in compliance with the SSUTA but remain associate members by electing to use the intrastate origin-based sourcing option. Once there are at least five associate members that elect this option, such states will become full members.

⁶ The original statutory changes required by the SSUTA were passed in 2007 (PC 602 of 2007). Some changes became effective in January 2009. PC 530 of 2009 postponed the effective date of the remaining required changes to July 1, 2011.

⁷ Any list of this type will vary depending whether it reflects the opinion of tax administrators, vendors, or ultimate buyers.

- Participating states, working together, have created new technological solutions to the challenges faced in dealing with the many differences in state sales tax laws. These include creation of rate and jurisdiction boundary databases, certified service providers and software, central registration and uniform tax filing, remittance and bad debt procedures.

Major requirements of the SSUTA that Tennessee has not yet fully conformed to include:⁸

- Ending both the local single article tax limitation (local tax limited to first \$1,600 of the price of a single article) and the additional state single article tax limitation (additional state sales tax of 2.75% imposed on the price of a single article in excess of \$1,600 but less than \$3,200).⁹
- Imposing one single state sales and use tax rate and ending any special tax rate provisions such as: special state sales tax rate on interstate business telecommunications, special rates on energy fuels, special rates on aviation fuel, special rates on water, special rates on tangible property sold to common carriers. To avoid tax increases in these areas, Tennessee and several other states have imposed or plan to impose replacement or alternate taxes in lieu of special sales tax rates. Such replacement taxes are allowed under the SSUTA for certain nonstandard and not defined products such as those noted above.
- Requiring local sales taxes collecting on telecommunication services to be situated to user address. Currently most telecommunication services are not situated to specific instate locations, but rather to the “out of state” category and then distributed to local governments using a special distribution arrangement. Additional telecommunication and communication and video service tax issues remain somewhat unresolved.
- The SSUTA requirement of a uniform return require increased taxpayer education at a time when the Department of Revenue is already dealing with the added administrative responsibilities for vehicle and title registration (previously in the Department of Safety) and administration of the expanded state and local business tax.
- Most Congressional bills introduced to require remote vendor collection of sales taxes require some reasonable level of vendor compensation for all sellers (in-state and remote vendors) and that the level of vendor compensation approved by the SSUTA Governing Board be reasonable. The Governing Board approved an amendment to the SSUTA (October

⁸ For a more complete list, see <http://www.tennessee.gov/revenue/streamlined/2009recertletter.pdf>

⁹ Caps are still allowed under SSUTA for sales of cars, boats, airplanes, and mobile and modular homes.

2010) to provide a certain minimum level of vendor compensation. States may delay paying compensation to in-state sellers for up to 15 months and “opt out” of federal collection authority if new revenues are not at sufficient levels to offset vendor compensation costs.

Losses from uncollected sales and use taxes continue to accumulate as states delay embracing the full requirements of the SSUTA. Estimated state and local sales tax losses from untaxed E-Commerce sales for Tennessee for the period 2007-2012 are \$1.8 billion.¹⁰ While the delay in Tennessee is partly a result of concerns over potential local sales tax losses by some local governments,¹¹ little discussion has focused on the overall size of the losses and the potential additional revenue that all local governments would receive as a result of additional state sales tax collections. A significant portion of state sales taxes are earmarked for local education and a portion of state sales taxes are earmarked for cities and some counties. It may be time to rethink the continuing delay by Tennessee in fully embracing the SSUTA.

Status of Federal Legislation

Federal legislation is stalled, according to Jim Eads, Executive Director of the FTA (Federal of Tax Administrators). According to a recent article in *State Tax Notes*¹² “While Eads is worried about congressional action on unwanted bills, he is also concerned about inaction on sales tax streamlining legislation (H.R. 5660, the Main Street Fairness Act), especially with its main sponsor, U.S. Rep. Bill Delahunt, D-Mass., retiring at the end of this term. Could streamlining rise up and get attached to something? “Yes,” Eads said. “Is it likely? No.”

Issues that have slowed federal action include formal adoption by SSUTA of a reasonable small-seller exemption (de minimus rule) and a reasonable level of vendor compensation. The current congressional bill requires vendor compensation for all retailers (remote and in-state vendors) collecting sales tax. As recently as early November, the Streamlined Sales Tax Governing Board did formally establish a small seller exemption (\$500,000) and the minimum compensation states must pay in vendor compensation. Whether these will be considered reasonable to Congress is yet to be determined.

Congressional approval has also been negatively affected by inaction and conformity avoidance by some participating states. The original SSUTA required destination sourcing of delivered sales. In states that impose local taxes, the

¹⁰ Excludes tax losses from other forms of remote sales. See Table 5 in *State and local government sales tax revenue losses from electronic commerce*: April 13, 2009, by Donald Bruce, William F. Fox, and LeAnn Luna. April 2009. Available at <http://cber.bus.utk.edu/ecommerce/ecom0409.pdf> on July 9, 2010.

¹¹ Resulting from some local sales taxes being distributed back to local governments where buyers live rather than to local governments where retail stores are located.

¹² *State Tax Notes*, October 4, 2010, p. 9.

local sales tax would be calculated based on the local tax rate, and sourced to the local government based on the address of the buyer. This in turn would require that instate sales of delivered taxable articles (in states with local taxes) also be sourced based on where delivered. This resulted in stalling and backpedaling by many states in which local taxes are imposed and destination sourcing of delivered goods is not the current method used for sourcing the tax.

Local governments in states where local taxes are sourced based on the situs of the retailer's location (not the delivered or buyer's location) feared a loss of local sales taxes. However the SSUTA, as amended (in December 2007), now provides an alternative (option) to destination-based sourcing for delivered goods in states with jurisdictions that impose local sales taxes. The availability of this option has been criticized by some in the business community as another example of SSTEP states backpedaling in order to avoid conformity with an initially agreed upon conforming SSUTA requirement.

Streamlined Sales Tax Project Timeline

- 45 states plus DC impose a sales tax (or comparable gross receipts tax)
- All states except Alaska, Delaware, Montana, New Hampshire and Oregon, impose a state sales tax.
- Alaska local governments impose sales taxes.

| Date | Event or Activity |
|-------------|--|
| 1967 | National Bellas Hess, Inc. v. Illinois Department of Revenue |
| 1992 | Quill Corp. v. North Dakota |
| 1998 | Internet Tax Freedom Act (ITFA) : federal law prohibited new federal taxes on Internet and state taxes, and prohibited any new state and local taxes for 3 years; also created Advisory Commission on Electronic Commerce (ACEC) to study issues involving the Internet and state and local taxes. |
| 1999 | NCSL and NGA joined together to call for "Streamlined Sales and Use Tax System for the 21st Century." |
| 1999-2000 | ACEC (Advisory Commission on Electronic Commerce) studied problem of Internet taxation and regulation. |
| 2000 | SSTP organized with participation of over 30 states during 2000-2003. |
| 2002 | Streamlined Sales and Use Tax Agreement (SSUTA) approved November 2002 by 33 participating states (plus DC). |
| 2003 | PC 357 enabled Tennessee to actively participate in the ongoing discussion of the SSTP. |
| 2004 | PC 959 established some definitive dates (instead of contingent effective dates) for Tennessee to conform to required changes that SSTP requires. |
| 2005 | SSUTA became effective October 1. |
| 2007 | PC 602: Changed Tennessee Statutes to Conform to SSUTA but not effective until 7/1/2009. |
| 2009 | Estimated state and local sales tax revenue losses in Tennessee in 2007 were \$261 million (E-Commerce only). ¹ |
| 2009 | PC 530 delayed full implementation of needed law changes (PC 602 of 2007) until July 1, 2011. |
| 2010 | Latest version of federal "The Main Street Fairness Act" (H.R. 5660). |
| 2011 | July 1, 2011 effective date for full conformity by Tennessee with SSUTA or punt again???? |

¹Donald Bruce, William F. Fox, and LeAnn Luna, "State and Local Government Sales Tax Revenue Losses from Electronic Commerce," April 13, 2009: University of Tennessee.



**STATE OF TENNESSEE
DEPARTMENT OF REVENUE
ANDREW JACKSON STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37242
TENNESSEE CONSUMER USE TAX**

Tennessee, like other states that impose a sales tax, also taxes the use of property brought into the state untaxed when purchased. This "use" tax was enacted in 1947, the same year as the sales tax, to complement the sales tax by taxing merchandise purchased from out-of-state sources that do not collect the state's sales tax. The use tax protects local merchants, who must collect sales tax, from unfair competition from out-of-state sellers who do not collect Tennessee's sales tax.

If Tennessee sales tax is added to the price of your purchase, you do not owe use tax. However, if you buy merchandise through the internet, over the telephone, from mail-order catalogs, etc., and sales tax is not added to the price, then you are responsible for paying the use tax directly to the Department of Revenue. Also, if you travel outside the state and purchase untaxed merchandise that is shipped to your Tennessee home, you are liable for the use tax.

The use tax is a combination of the state tax rate of 7% (5.5% on food or food ingredients) plus the rate levied by your local government, generally 2.25%. (A local government rate chart is available.) The tax is applied to the purchase price of the merchandise plus any delivery or other charges that the merchant adds to your bill.

Effective January 1, 2009, the local use tax rate on purchases or downloads of digital videos, digital books, and digital music, as defined in Tenn. Code Ann. Section 67-6-102, is established at 2.50% regardless of the actual local tax rate in effect in the jurisdiction of the user and consumer.

The local rate is applicable on the first \$1,600 of the purchase price of any single article of tangible personal property. In addition, there is a state single article rate of 2.75% that is applicable to the purchase price amount of any single article purchased from \$1,600.01 to a maximum of \$3,200. Instructions for calculating the state and local sales tax on single article purchases are provided on the reverse side of the return below.

Depending on the frequency of purchases, consumers must file the use tax return and pay the taxes either monthly, quarterly, semiannually, or annually. The return is due on the 20th of the month following the close of the applicable period. For example, if you file an annual calendar year return, the return is due on January 20. If you file quarterly, returns are due on April 20, July 20, October 20, and January 20 of the following year. For your convenience, if you are reporting use tax on items, some of which are taxed at the 5.5% state rate and others that are taxed at the 7% state rate, you may wish to file a separate return for each state tax rate.

We urge you to voluntarily report your tax liability. A consumer use tax return is attached to this letter for your convenience. If you need additional assistance, please contact the Taxpayer and Vehicle Services Division at (800) 342-1003 or, in Nashville, at (615) 253-0600. The consumer use tax return and information about the use tax are also available on the department's web site: www.TN.gov/revenue.

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TENNESSEE DEPARTMENT OF REVENUE
TENNESSEE CONSUMER USE TAX RETURN

(Circle One) SSN or FEIN _____

Date of Purchase: _____

Name: _____

1. Total Purchase Price \$ _____

Address: _____

2. State Use Tax* \$ _____

3. Local Tax - Nondigital Items** \$ _____

City: _____ State: _____ Zip: _____

4. Local Tax - Digital Items** \$ _____

County of _____
Residence: _____

5. State Single Article Tax*** \$ _____

Phone: _____

6. Total tax Owed (total of Lines 2 through 5) \$ _____

Check one below:
Purchase is for: an individual _____ a business _____

Taxpayer Signature Date

*The use tax rate is the same as the sales tax rate.

**Local tax rate applies to the first \$1,600 of the cost of each item purchased; if local tax rate is unknown, see local rate chart. Local tax on digital purchases is 2.50% regardless of location of user.

***See example on back for single items over \$1,600.

Instructions for calculating sales and use tax on single item. If no tax was paid to the seller, calculate 7% of the purchase price for state tax plus the appropriate local tax and state single article tax. In addition, a state sales or use tax of 2.75% is levied on the amount of a single article in excess of \$1,600 and less than or equal to \$3,200. The first \$1,600 of the sales price will continue to be taxed at the appropriate local rate. The amount from \$1,600.01 to \$3,200 will be taxed at a uniform rate of 2.75%. In the example below, the purchaser had two purchases - one a single item of \$9,950; the other a digital item of \$50. The user's non-digital local tax rate is 2.25%

| Example: | |
|---|-------------|
| 1. Net Purchase Price | \$10,000.00 |
| 2. State Tax at 7% | \$700.00 |
| 3. Local Option - Non-digital (Tax assessed on first \$1,600) | \$36.00 |
| 4. Local Option - Digital Items (Local tax rate is 2.50%) | \$1.25 |
| 5. State Single Article on price of \$1,600.01 - \$3,200 at 2.75% | \$44.00 |
| 6. Total Tax Due on this Example | \$781.25 |