LEGISLATIVE SERVICES AGENCY

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# ISSUE REVIEW

*Fiscal Services Division*

**October 20, 2010**

## Streamlined Sales and Use Tax Agreement

### ISSUE

During the 2010 Legislative Session, S.F. 2375 (Streamlined Sales/Use Tax Administration Act) was approved by the General Assembly. The Act modified the Iowa sales/use tax law to keep the State in compliance with the national Streamlined Sales and Use Tax Agreement. This ***Issue Review*** provides a brief update on the status of the Agreement and its impact on Iowa.

### AFFECTED AGENCIES

Department of Revenue

### CODE AUTHORITY

Chapter 423

### BACKGROUND

With enactment of H.F. 683 (Miscellaneous Appropriations and Sales Tax Revisions Act) during the 2003 First Extraordinary Session, the General Assembly noted intent to participate in the national Streamlined Sales and Use Tax Agreement. The Agreement included modifications to the Iowa sales and use tax code to align with model streamlined sales tax language. Iowa began participating as a full member, with 17 other states, in the Agreement upon implementation of the multistate agreement in 2005 (see **Attachment A** for current state status).[1]

Prior to establishment of the Streamlined Sales and Use Tax Agreement, the U.S. Supreme Court had ruled in two separate cases that a business must have a physical presence or "nexus" in a state to collect sales tax from the consumer.[2] The growth of e-commerce, increased Internet sales, eroding state sales tax bases, and the fairness to local merchants led to the Agreement. The Agreement was the result of a joint effort of the National Governor's Association (NGA), the National Conference of State Legislatures (NCSL), the Federation of Tax Administrators (FTA), and private sector representatives from 35 states.[3]

According to the Streamlined Sales and Use Tax Governing Board, the purpose of the Agreement is to simplify and modernize sales and use tax collection by reducing the burden of

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[1] http://www.iowa.gov/tax/educate/SLSTIntro.html, Iowa Department of Revenue

[2] *Streamlined Sales and Use Tax Agreement – 2006 Status Presentation*, National Conference of State Legislatures (NCSL)

[3] *Streamlined Sales and Use Tax Agreement Issue Paper*, National Conference of State Legislatures (NCSL), May 14, 2010

tax compliance. The Agreement stresses administration systems improvement for sellers through:[4]

- State level administration of sales and use tax collections.
- Uniformity in the state and local sales/use tax bases.
- Uniformity of major tax base definitions.
- Central and electronic registration system for all member states.
- Simplification of state and local sales/use tax rates.
- Uniform sourcing rules for all taxable transactions.
- Simplified administration of exceptions for sales/use tax.
- Simplified sales/use tax returns and tax remittances.
- Protection of consumer privacy.

With cooperation among states and remote sellers, it was anticipated that simplification of administration of sales and use tax would lead to an increase in the number of remote sellers that would voluntarily collect and remit sales tax to states that were participating in the Agreement.

There is a common misconception that Internet, e-commerce, and other remote sales from sellers without a nexus within a state are not subject to sales or use tax. However, if the seller does not collect and remit sales or use tax, it is the purchaser's responsibility to remit the tax to the state if the purchased item is subject to the state sales or use tax. In many cases, purchasers are not aware of this and enforcement by states against individual purchasers is difficult.

### Examples of How the Agreement Works

These examples provide an overview of how sales tax revenues in Iowa may be impacted by the Streamlined Sales Tax Agreement. The consumer in these examples is an Iowa resident of Story County and makes Internet purchases subject to sales/use tax totaling $200.00. Story County has a state sales tax rate of 6.0% and a local option sales tax rate of 1.0%.

**Example 1:** A resident of Story County makes a retail purchase over the Internet from a retail company located in Maine and the retail company has volunteered to collect and remit sales tax. Since Iowa is a full member state and the company has voluntarily agreed to collect tax on remote sales, the company will collect $214.00 from the Iowa resident and remit $14.00 to the Iowa Department of Revenue in total sales/use tax ($12.00 State sales tax and $2.00 local option sales tax).

**Example 2:** A resident of Story County makes a retail purchase over the Internet from a retail company located in Texas and the company has not volunteered to collect and remit sales tax. Since the company does not collect sales tax on the merchandise, the merchandise purchased is subject to use tax totaling $14.00 and should be remitted by the consumer. However, in most cases, the purchaser does not remit the use tax.

## CURRENT SITUATION

As of October 2009, there were 20 full member states and three associate member states (Georgia has petitioned to become a full member state beginning in 2011). Full member states are those with laws and rules in line with the Streamlined Sales and Use Tax Agreement while associate members are states with laws and rules that will put the state in compliance within 12 months. **Figure 1** provides a breakdown of the status of each state (also see **Attachment A**).

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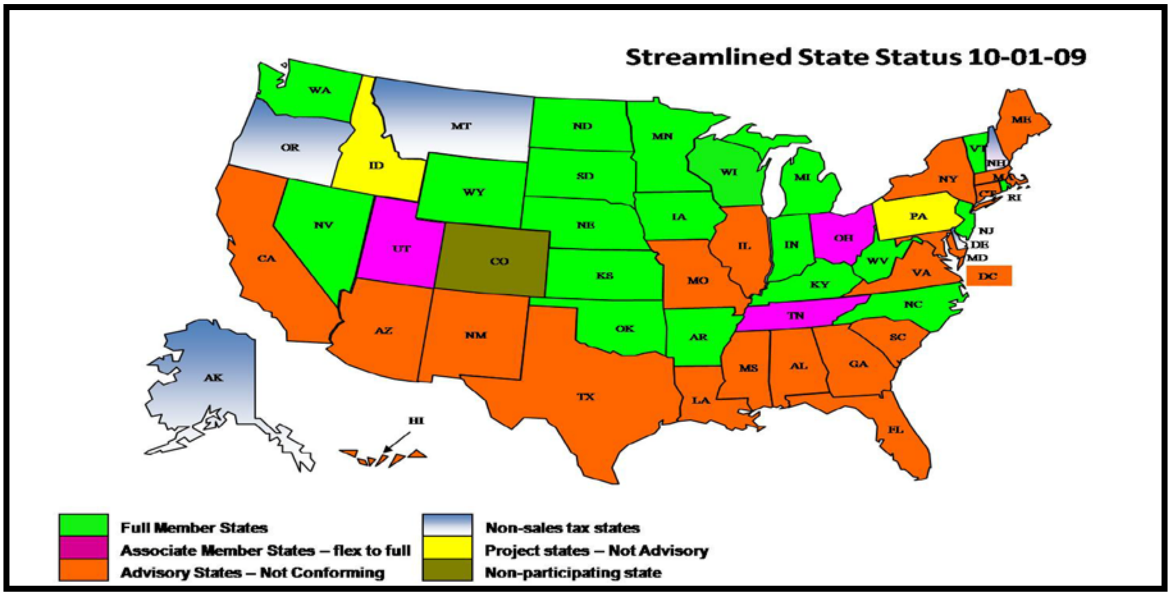
[4] *Streamlined Sales and Use Tax Agreement*, Section 102

In addition to the 23 member states, there are estimated to be over 1,100 sellers/retailers that have volunteered to collect taxes on out-of-state sales.

**Figure 1**




Source: Streamlined Sales Tax Governing Board, Inc. http://www.streamlinedsalestax.org/index.php?page=modules

## Streamlined Sales Tax Governing Board

The Streamlined Sales Tax Governing Board is responsible for administering and implementing the provisions of the Streamlined Sales and Use Tax Agreement. Membership of the Governing Board consists of up to four representatives from each member state and each member state is limited to one vote. The Governing Board has four specified standing committees and has authority to create other standing committees as needed. Additionally, the Governing Board has two advisory councils that provide advice on pertinent issues. Standing Committees and advisory councils include:

- Nominating Committee: Members nominate individuals for officer and director positions for Governing Board Committees.
- Compliance Review and Interpretations Committee: Members make recommendations and interpretations of the Agreement rules to the Governing Board.
- Finance Committee: Members prepare and monitor the Governing Board budget.
- Issue Resolution Committee: Members promulgate rules and implement the issue resolution process.
- State and Local Advisory Council: Members include one representative from each member state and advise the Governing Board on administration of the Agreement including membership, noncompliance issues, and interpretation.
- Business Advisory Council: Members include representatives of businesses representing differing sizes and industry types. These members advise the Governing Board on administration of the Agreement including membership, noncompliance issues, and interpretation providing a business perspective.

**Status of Congressional Legislation**

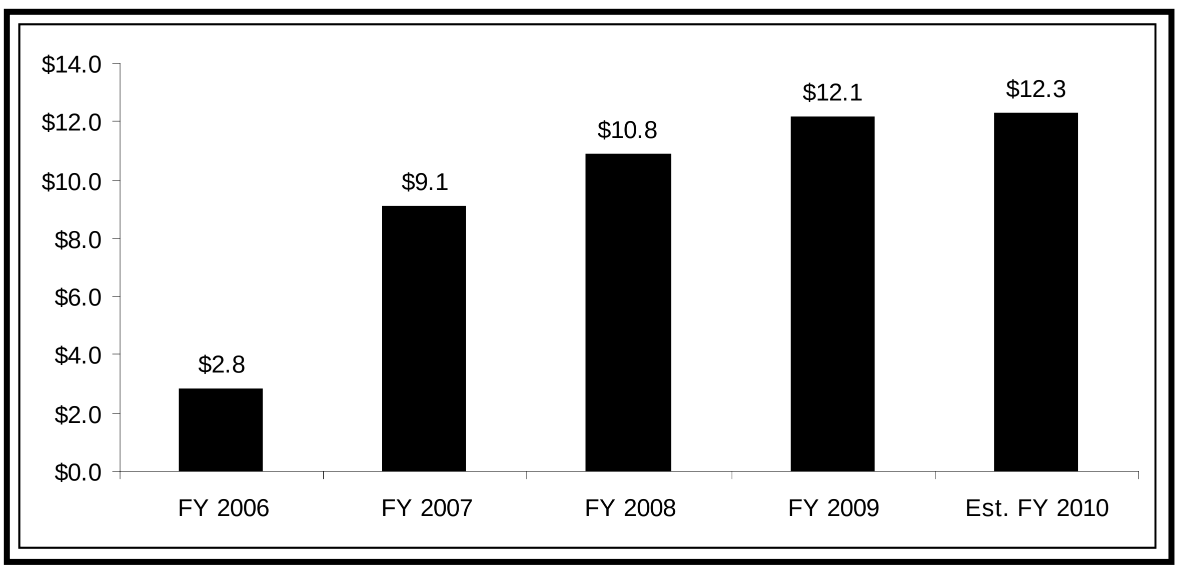
Participation in the Agreement is currently voluntary for both states and businesses. However, there is pending legislation before Congress that would provide states the authority to require remote sellers to collect sales tax from purchases and remit the sales tax to that state. The bill, H.R. 5660 (Main Street Fairness Act) has been assigned to the House Committee on Judiciary (status as of September 2010). It is anticipated that enactment of this legislation would have a major impact on state sales tax revenues for states that are participating in the Agreement.

**Iowa Streamlined Sales/Use Tax Revenues**

Original fiscal estimates provided when H.F. 683 was enacted in 2003 were based on the amount of additional sales tax revenue anticipated from participation in the Agreement and totaled $1.0 million in FY 2004, $15.0 million in FY 2005, $71.8 million in FY 2006, and $71.8 million in FY 2007.[5]

The Iowa Department of Revenue tracks revenue from the state's participation in the Agreement. Based on the Department's data, the tax revenue from the Agreement has increased from $2.8 million in FY 2006 to $12.3 million in FY 2010 (see **Chart 1**). Since the Agreement did not go into effect until 2005, State sales tax revenue generated from the Agreement was not received until FY 2006. Additionally, tax revenues as a result of the Agreement have lagged behind the original estimate, in part, due to a lower than anticipated level of remote seller participation than initially estimated. As noted earlier, business participation is voluntary and the level of participation will have an impact on the amount of sales tax revenue generated as a result of the Agreement.

**Chart 1**
**Iowa Sales Tax Revenue from Participation in the Streamlined Sales Tax Agreement**
(Dollars in Millions)




## POTENTIAL TAX REVENUE IMPLICATIONS

Membership in the Agreement requires the state sales tax law to conform to the specifications within the Agreement. Any deviations may result in the removal of membership status with the

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[5] 2003 Session Report, H.F. 683 Analysis, Legislative Services Agency

Agreement and would likely result in the loss of sales tax revenue generated as a result of participation in the Agreement.

A report published by the University of Tennessee estimates the uncollected tax revenue from e-commerce sales will total $12.6 billion nationally, including $98.4 million in Iowa, by 2012.[6] However, there may be limitations of the revenue estimate that may overstate the actual amount of uncollected tax revenue from e-commerce sales in Iowa. Additionally, the report notes that this estimate includes only sales from e-commerce and does not include estimates for other types of remote commerce. Based on the estimate in the report, enactment of the federal Main Street Fairness Act could significantly increase Iowa's sales/use tax revenue as long as Iowa maintains membership status with the Agreement.

However, as noted above, changes in state sales/use tax legislation that do not conform to the Agreement specifications could result in removal from membership. Modifying sales tax exemptions or the sales/use tax rate would not be in violation of the Agreement, but creating an excise tax on an item could potentially be in violation of the Agreement. For example, if a member state enacted an additional excise tax on soft drinks of $0.01 per can or bottle that would jeopardize membership status. In this example, the state may be able to generate $16.0 million from the additional excise tax, but lose sales tax revenue generated from membership status with the Agreement.

Future growth in sales tax revenue collected due to compliance with the Agreement is unknown. There are factors that will have an impact on growth of this tax revenue that are uncertain. Included in these factors:

- The number of remote sellers that voluntarily participate in the Agreement: If the number of remote sellers increases, this would potentially lead to increased sales tax revenue for member states.
- Status of pending congressional legislation. Federal approval of the Main Street Fairness Act would likely significantly increase sales tax revenue for member states.
- Incentives provided to businesses that participate in the Agreement: There may be amnesty provisions or additional incentives for specific businesses to participate in the Agreement that may result in tempered sales tax revenue growth for member states.
- Vendor Compensation: Currently, eleven of the member states "compensate" remote sellers with a discount on sales tax remitted. Discount rates range from 0.25% to 2.25% depending upon level of sales. Any federal legislation that passes may contain a "vendor compensation" provision. Iowa does not currently compensate vendors, remote or otherwise. Any vendor compensation provision would impact the amount of revenue Iowa would receive under the Agreement.

An increase in Iowa's sales and use tax revenue as a result of its membership status with the Streamlined Sales and Use Tax Agreement is likely to continue to in future years. However, the amount of that increase hinges on an increase of voluntary participation by business entities or enactment of federal legislation that would provide member states the ability to require remote sellers to collect and remit sales tax.

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*NOTE: A special thank you to Victoria Daniels of the Department of Revenue for providing valuable input to the LSA in helping with the publication of this document.*

[6] Donald Bruce, William F. Fox, and LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*, University of Tennessee, April 13, 2009, p. 26

**ATTACHMENT A**

## Streamlined Sales Tax Agreement State Status

| State | Status |
|---|---|
| Arkansas | Full Member |
| Indiana | Full Member |
| Iowa | Full Member |
| Kansas | Full Member |
| Kentucky | Full Member |
| Michigan | Full Member |
| Minnesota | Full Member |
| Nebraska | Full Member |
| Nevada | Full Member |
| New Jersey | Full Member |
| North Carolina | Full Member |
| North Dakota | Full Member |
| Oklahoma | Full Member |
| Rhode Island | Full Member |
| South Dakota | Full Member |
| Vermont | Full Member |
| Washington | Full Member |
| West Virginia | Full Member |
| Wisconsin | Full Member |
| Wyoming | Full Member |
| Tennessee | Associate Member |
| Ohio | Associate Member |
| Utah | Associate Member |
| Georgia | Advisory (Petitioned to become full member beginning Jan. 1, 2011) |
| Alabama | Advisory |
| Arizona | Advisory |
| California | Advisory |
| Connecticut | Advisory |
| Florida | Advisory |
| Hawaii | Advisory |
| Illinois | Advisory |
| Louisiana | Advisory |
| Maine | Advisory |
| Maryland | Advisory |
| Massachusetts | Advisory |
| Mississippi | Advisory |
| Missouri | Advisory |
| New York | Advisory |
| South Carolina | Advisory |
| Texas | Advisory |
| Virginia | Advisory |
| Idaho | Project State |
| Pennsylvania | Project State |
| Alaska | No sales tax |
| Delaware | No sales tax |
| Montana | No sales tax |
| New Hampshire | No sales tax |
| Oregon | No sales tax |
| Colorado | Not Participating |

Status as of October 2010.