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Legislative Service Commission

Sub. S.B. 143*

124th General Assembly
(As Reported by H. Ways and Means)

Sens. Blessing, Amstutz, DiDonato, Mead, Spada, Finan, Harris

BILL SUMMARY

- Enacts the National Conference of State Legislatures' model act, the Simplified Sales and Use Tax Administration Act, for the development of a voluntary system for the collection of sales and use taxes from remote sellers.

- Requires that the state participate in multi-state discussions to develop the system and review and amend the Streamlined Sales and Use Tax Administration Agreement adopted by NCSL.

- Permits the Tax Commissioner to enter into the Agreement with other states if the final Agreement contains certain standards and establishes requirements with which all states that sign the Agreement must comply, and provided the General Assembly authorizes entry into the Agreement.

- Effective August 1, 2002, implements a sales tax sourcing provision for mobile telecommunications service to comply with the federal Mobile Telecommunications Sourcing Act.

- Disallows use tax reporting on the income tax return for purchases where tax already has been paid tax to another state.

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* *This analysis was prepared before the report of the House Ways and Means Committee appeared in the House Journal. Note that the list of co-sponsors and the legislative history may be incomplete.*

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CONTENT AND OPERATION

BACKGROUND OF EFFORT TO COLLECT SALES AND USE TAXES FROM REMOTE SELLERS

Ohio's limited ability to tax remote sellers

With the advent of the Internet, Ohio faces an increasing problem of collecting state and local sales and use taxes from sellers who are not located in Ohio and have practically no physical contacts (nexus) with the state, other than making sales over the Internet to consumers residing in Ohio. The United States Constitution's Commerce Clause, Art. I, §8, cl. 3, limits state burdens on interstate commerce and bars states from collecting sales or use taxes from remote sellers unless those sellers have substantial nexus with taxing states.

A number of United States Supreme Court decisions provide guidance for determining the type of contacts a remote seller must have with a state in order to establish substantial nexus and trigger the state's ability to tax the seller. The leading case is *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), which held that a vendor, whose only connection with customers in a taxing state was by common carrier or the United States mail, was free from state-imposed duties to collect sales and use taxes, because the vendor lacked the substantial nexus with the taxing state that is required by the Commerce Clause. The Court came to this conclusion, despite the fact that the remote seller, a mail-order house incorporated in Delaware with no offices or employees in North Dakota, made annual sales by mail of almost $1 million to approximately 3,000 North Dakota customers.

NCSL's and the states' answer to losses in sales and use tax revenues

As a result of increased sales via the Internet and plummeting sales and use tax collections in most states, in 1999, the National Conference of State Legislatures' (NCSL) Executive Committee established a Special Task Force on State and Local Taxation of Telecommunications and Electronic Commerce. The Task Force examined the collection and nexus issues, and on January 14, 2000, proposed model legislation to assist states in the development of a **voluntary**, streamlined multi-state sales and use tax collection system to address the Commerce Clause conflicts that arise when states attempt to collect those taxes from a remote seller. The intent of the model legislation was to authorize the appropriate state authority to participate in discussions with other states to develop the streamlined system.

The 123rd General Assembly's reaction to the model legislation was to enact Section 6 of Sub. H.B. 483, effective September 21, 2000, which granted the Tax Commissioner the authority to discuss with other states the development of the simplified tax collection system and participate in a pilot project with them. Section 6 of H.B. 483 authorized the Commissioner to address administration of the collection system, and to discuss a mechanism for compensating parties for the development and operation of that system. The Commissioner also could discuss the establishment of minimum statutory measures necessary for state participation and could enter into joint agreements to test methods for simplifying tax administration, so long as the agreements terminate by December 31, 2001.

As the discussions on developing a voluntary sales and use tax collection system continued, NCSL's Special Task Force developed, and the NCSL Executive Committee unanimously endorsed on January 27, 2001, the Simplified Sales and Use Tax Administration Act and the Streamlined Sales and Use Tax

Agreement.[1] NCSL has been urging states to adopt the Act and Agreement in their legislatures, so that in-state and out-of-state merchants are treated in a fair and an equitable manner.

The Simplified Sales and Use Tax Administration Act

The bill, by enacting the Simplified Sales and Use Tax Administration Act (model act), authorizes the state to participate in the next phase of multi-state discussions, and contains an "outline" of a streamlined sales and use tax collection and administration system. Generally, the model act envisions using advanced technology to collect sales and use taxes. States and sellers voluntarily participate in the simplified system by registering with a central, electronic registration system established by states that are "members" to the Streamlined Sales and Use Tax Agreement.[2] By doing so, the sellers are registered in each of the member states and agree to collect and remit sales and use taxes to the member states. A seller pays the taxes by one of the following methods: (1) by having a "certified service provider," which is an agent certified jointly by the member states, perform all of the seller's sales and use tax functions, including remitting the taxes to each member state, (2) by using a "certified automated system" (software certified jointly by the member states) to calculate the tax imposed by each jurisdiction on a transaction, determine the amount to remit to the appropriate state, and maintain a record of the transaction, with the seller having the responsibility to remit taxes to a state, or (3) by using its own system to calculate the tax due each jurisdiction. This last method may only be used by a seller that has sales in at least five member states, has total sales revenues of at least $500 million, and enters into a performance agreement with the member states.

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[1] *At about the same time, the National Governors' Association and others participated in the Streamlined Sales Tax Project, composed largely of state revenue officials. The Project developed a model act and agreement on which NCSL's model act and agreement are based. There are some differences between the documents, namely, the Project's agreement includes provisions regarding uniform definitions, procedures for bad debt deductions, uniform rounding rules, caps and thresholds on rates, and sales tax holidays. This bill contains the Project's uniform definition of "delivery charges" (see "**Uniform definition of delivery charges**," below).*

[2] *Under Ohio law, "vendor" is the term normally used in the sales tax law for persons in Ohio making sales, and "seller" is used in the use tax law for persons outside Ohio making sales to consumers in Ohio. The model act encompasses both--a "seller" is any person making sales, leases, or rentals of personal property or services, regardless of location.*

The Streamlined Sales and Use Tax Agreement

The Streamlined Sales and Use Tax Agreement (interstate agreement) provides states with the structure to simplify their existing sales and use tax collection systems by changing state statutes to establish the system envisioned by the model act. The interstate agreement requires state-level administration of sales and use taxes; a common tax base for a state and its local taxing jurisdictions; central, online registration for sellers; uniform standards for the administration of exempt sales, tax returns and remittances, and sourcing transactions (designating where a sale occurs); and protection of consumer privacy. States must outline in their statutes any monetary allowances that are to be given to certified service providers and sellers using certified automated systems or proprietary systems.

The interstate agreement also restricts the frequency of changes in local sales and use tax rates, and requires timely notice to sellers of tax rate and boundary changes for local taxing jurisdictions. Under the agreement, state statutes must ensure that seller registration will not be used as a factor in determining a seller's nexus with any state for any other tax.

State action

States that enact the **model act** before July 1, 2003, are entitled to continue participating in discussions to review and amend the **interstate agreement** by a simple majority vote, with one vote per state. If a state passes only the model act, the state has until July 1, 2003, to adopt the necessary laws to comply with the interstate agreement. After that date, a state that has not brought its sales and use tax collection system into compliance with the interstate agreement is no longer entitled to participate in amending it or deciding matters regarding joint contracts between complying states and vendors of automated systems.

States that enact the model act and change their laws to comply with the interstate agreement before July 1, 2003, may execute an adopting resolution specifying the proposed date of entry into the interstate agreement. A state must agree to abide by the interstate agreement and provide with the resolution a certification of compliance with the terms of the agreement, citing statutes and regulations supporting compliance. The interstate agreement becomes effective when five states have completed adopting resolutions. States become initial member states by being found in compliance with the agreement by a ¾ vote of the other initial states.

Member states vote whether a petitioning state is in compliance and becomes a member to the interstate agreement. Member states also organize to govern each state's compliance with the agreement and may take actions necessary to administer the agreement.

As of September 4, 2001, 19 states, including Indiana, Kentucky, and Illinois, have enacted some form of the model act. In four other states, including Michigan and Pennsylvania, the model act has been introduced or has progressed further in the legislative process. Some of these states also may have made changes in their laws to comply with the interstate agreement. Alabama, Iowa, Kansas, Missouri, and Vermont adjourned their legislatures without passage of the model act.

This bill locates the model act in new R.C. Chapter 5740., with the sections taking effect the 91st day after the day on which the bill is filed in the Secretary of State's office. The bill also amends Ohio's sales and use tax laws and enacts corresponding laws to reflect much of the tax simplification framework contained in the interstate agreement. Most of those changes have a delayed effective date of July 1, 2003.

ENACTMENT OF THE SIMPLIFIED SALES AND USE TAX ADMINISTRATION ACT (MODEL ACT)

Ohio's participation in multi-state discussions

(R.C. 5740.01 and 5740.02; Section 5)

The bill enacts the model act so that Ohio may continue to participate in the multi-state discussions, and review and amend the interstate agreement. The bill repeals Section 6 of Sub. H.B. 483 of the 123rd General Assembly, but generally codifies the language in that provision to provide that Ohio must participate in discussions with other states regarding the development of a streamlined sales and use tax system to reduce the burden and cost for all sellers to collect Ohio's sales and use taxes. The state also must discuss amending the terms of the interstate agreement so that it embodies the requirements set forth for it in the model act and the bill (see "***Requirements for the interstate agreement***," below). For purposes of these discussions, the Tax Commissioner, or the Commissioner's designee, and two other delegates are to represent Ohio. The Commissioner or the designee is the chairperson of delegation. The Speaker of the House of Representatives and the President of the Senate each choose one delegate. In all matters where voting by the member states is required to amend the interstate agreement, the delegation must unanimously agree before the state's vote on the matter may be cast. The chairperson is charged with casting the state’s vote.

Ohio's delegation may not participate in the discussions unless the discussions are held in accordance with rules that are the same as or substantially similar to requirements of Ohio's "open meetings" law. Under Ohio's open meeting law, written notice of each meeting must be provided at least 30 days in advance to news media requesting notice; the meetings must be open to the public;

minutes must be prepared and available to the public; a member must be present in person in order to be considered present and be able to vote; and notice of meetings must be provided to interested persons who request notification. Executive (closed) sessions are permitted, but only to consider certain matters--e.g., personnel decisions and attorney-client discussions. And actions taken during a meeting are not valid unless the foregoing requirements have been satisfied.

Authority to enter into the interstate agreement and adopt rules

(R.C. 5740.01(D) and 5740.03)

The Tax Commissioner may enter into the interstate agreement with one or more other states, but only if the General Assembly authorizes the Commissioner to enter into the agreement and only if the agreement satisfies the requirements described below. The manner in which the General Assembly would grant that authority is not specified in the bill. (The bill itself does not authorize the Commissioner to enter into the agreement.) In furtherance of the agreement, the Commissioner may act jointly with other "member states," meaning those states that have signed the interstate agreement, to establish standards for certification of service providers and automated systems, establish performance standards for multi-state sellers, and procure goods and services. The Commissioner may take other actions reasonably required to implement the model act, including adopting rules.

Requirements for the interstate agreement

(R.C. 5740.05)

Under the bill, the Tax Commissioner is prohibited from entering into the interstate agreement unless the agreement requires states to meet certain standards (by amending their state laws). The agreement must:

(1) Set restrictions to limit over time the number of state sales and use tax rates;

(2) Establish uniform standards for attributing the source of transactions to taxing jurisdictions, for the administration of exempt sales, and for sales and use tax returns and remittances;

(3) Provide a central, electronic registration system that allows a seller to register to collect sales and use taxes for, and remit them to, all member states;

(4) Provide that registration with the central registration system and the collection of sales and use taxes in the member states will not be used as a factor in determining whether the seller has nexus with a state for any tax;

(5) Provide for reduction of the burdens of complying with local sales and use taxes through (a) restricting variances between the state and local tax bases, (b) requiring states to administer any sales and use taxes levied by local jurisdictions within the states so that sellers collecting and remitting those taxes will not have to register or file returns with, remit funds to, or be subject to independent audits from, local taxing jurisdictions, (c) restricting the frequency of changes in the local sales and use tax rates and setting effective dates for the application of local jurisdictional boundary changes to local sales and use taxes, and (d) providing notice to sellers and certified service providers of changes in local sales and use tax rates and in the boundaries of local taxing jurisdictions;

(6) Outline any monetary allowances that are to be provided by the member states to sellers or certified service providers. The interstate agreement must allow for a joint public and private sector study of the compliance cost on sellers and certified service providers to collect sales and use taxes for state and local governments under various levels of complexity, to be completed by July 1, 2002.

(7) Require each state to certify compliance with the interstate agreement's terms prior to becoming a member of the agreement, and to maintain compliance, under the laws of the member state, with all provisions of the agreement while a member;

(8) Require each member state to adopt a uniform policy for certified service providers that protects the privacy of consumers and maintains the confidentiality of tax information;

(9) Provide for the appointment of an advisory council of private sector representatives and an advisory council of non-member state representatives to consult with in the interstate agreement's administration.

Tax liability for sellers that use certified service providers or automated or proprietary systems

Use of a certified service provider

(R.C. 5740.07(A))

The bill provides that a certified service provider is the agent of the seller with whom the provider has contracted for the collection and remittance of sales and use taxes. As the seller's agent, the certified service provider is liable for sales and use taxes due each member state on all sales transactions it processes for the seller, but a seller that contracts with a certified service provider is not liable to Ohio for sales or use taxes due on transactions processed by the provider, unless the seller misrepresented the type of tangible personal property or services it sells, or committed fraud. In the absence of probable cause to believe that the seller made a material misrepresentation or has committed fraud, the seller is not subject to audit of the transactions processed by the certified service provider, but is subject to audit for transactions that are not processed by the provider. The member states acting jointly may perform a system check of the seller and review the seller's procedures to determine if the certified service provider's system is functioning properly, and the extent to which the seller's transactions are being processed by the provider.

Use of a certified automated system

(R.C. 5740.07(B))

Any person who provides a certified automated system is responsible for the proper functioning of that system and is liable to Ohio for underpayments of the sales and use tax attributable to errors in its functioning. A seller that uses a certified automated system remains responsible and is liable to Ohio for reporting and remitting sales and use taxes.

Use of a proprietary system

(R.C. 5740.07(C))

A seller that has a proprietary system for determining the amount of sales or use tax due on transactions and has signed a performance agreement establishing tax performance standards for that system is liable for the failure of the system to meet the performance standards.

Interstate agreement's relationship to Ohio law

(R.C. 5740.01(E), 5740.04, and 5740.06)

The bill provides that no provision of the interstate agreement, in whole or in part, invalidates or amends Ohio law, nor does adoption of the agreement by Ohio amend state law. Implementation in this state of any condition of the interstate agreement, whether adopted before, at, or after Ohio's membership in the agreement, must be by the action of Ohio.

Under the bill, the interstate agreement is characterized as an accord among individual cooperating sovereigns in furtherance of their governmental functions. The agreement 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 laws of each member state.

The interstate agreement binds and inures only to the benefit of Ohio and the other member states. No person, other than a member state, is an intended beneficiary of the agreement. Any benefit to a person (meaning an individual, trust, estate, fiduciary, partnership, limited liability company, limited liability partnership, corporation, or any other legal entity) other than a state is established by the law of Ohio and the other member states and not by the terms of the interstate agreement.

The bill further provides that no person has any cause of action or defense under the interstate agreement or by virtue of Ohio's approval of it. No person may challenge, in any action brought under any provision of law, any action or inaction by any department, agency, or other instrumentality of Ohio, or any political subdivision of this state, on the ground that the action or inaction is inconsistent with the agreement.

Ohio law, or the application thereof, cannot be declared invalid as to any person or circumstance on the ground that the law or its application is inconsistent with the interstate agreement.

Consumer privacy requirements

(R.C. 5740.08)

The bill requires that all certified service providers preserve the privacy of consumers who buy, lease, or rent tangible personal property or services from sellers with whom the provider has contracted for the collection and remittance of sales and use taxes to Ohio. A consumer's information must be protected "in the same manner as required of the Department of Taxation for taxpayer information." The certified service provider must use a certified automated system to perform sales and use tax calculations, remittances, and reporting that does not retain the personally identifiable information of consumers, except to determine whether a consumer's status or intended use of the goods or services purchased is exempt from the sales or use tax, to investigate fraud by a consumer or seller, or to the extent necessary to ensure the reliability of the providers' technology and certified automated system in performing all of a seller's sales and use tax functions.

A certified service provider must provide technical, physical, and administrative safeguards to protect personally identifiable information from unauthorized access and disclosure, and must provide to consumers clear and conspicuous notice of its information retention and sharing practices, including what information it collects, how the information collected is used, and whether the information is disclosed to other member states. A provider that retains personally identifiable information must notify consumers of its intent to retain that information and must afford consumers reasonable access to their data and the opportunity to correct inaccurately recorded data.

If any person, other than a member state, seeks to discover a consumer's personally identifiable information, a reasonable and timely effort must be made by the certified service provider to notify the consumer of the request.

Notwithstanding the bill's privacy provision, the laws of Ohio regarding the collection, use, and maintenance of confidential taxpayer information remain applicable and binding. The agreement does not enlarge or limit Ohio's authority to do any of the following:

(1) Conduct audits or other reviews as provided under the interstate agreement or Ohio law;

(2) Provide records, pursuant to existing law regarding the availability of public records, or to governmental agencies under disclosure laws;

(3) Prevent the disclosure of confidential taxpayer information in accordance with existing state tax laws;

(4) Prevent, consistent with federal law, the disclosure or misuse of federal return information obtained under a disclosure agreement with the Internal Revenue Service;

(5) Collect, disclose, disseminate, or otherwise use anonymous data for governmental purposes.

The bill's privacy provision does not enlarge or limit the privacy policies of any seller that has selected a certified service provider as its agent to perform all of its sales and use tax functions.

Any certified service provider that fails to comply with this privacy law is subject to investigation by the Tax Commissioner and the Attorney General, and prosecution by the Attorney General.

MISCELLANEOUS CHANGES TO THE SALES AND USE TAX LAWS

Attributing the source of mobile telecommunications services to taxing jurisdictions

(R.C. 5739.01(B)(3), (AA), and (VV), 5739.033(D), 5739.034, and 5741.05(A); Section 4)

Continuing law provides that the source of a sale of telecommunications service that originates or terminates in Ohio and is charged in the vendor's records to the consumer's telephone number or account in Ohio, or that both originates and terminates in Ohio, is attributed to the telephone number or account as reflected in the vendor's records. But in 2000, the federal Mobile Telecommunications Sourcing Act, 4 U.S.C.A. 116-126, was enacted, which explicitly preempts state sourcing law for mobile telecommunications services, effective August 1, 2002. The Act applies to any tax, charge, or fee levied by a taxing jurisdiction as a fixed charge for each customer or measured by gross amounts charged to customers for mobile telecommunications services. The Act defines "mobile telecommunications service" as commercial mobile radio service--generally, a mobile service that is provided for profit, is interconnected with the public switched network, and is available to the public.

The Mobile Telecommunications Sourcing Act determines how states and local governments are to treat charges for mobile telecommunications services, where such services are deemed to have occurred, and which taxing jurisdictions may tax those services. To comply with the Act, the bill removes mobile telecommunications service from the existing state telecommunications service sourcing provision and definition, and creates a separate sourcing provision and definition that is consistent with the federal Act. The bill requires that, on and after August 1, 2002, if a vendor provides mobile telecommunications service, the situs of all sales of that service is the residential or business street address that is the "customer's place of primary use" of the service (which is addressed in the Act) that is within the "licensed service area" of the "home service provider" under the Act. The licensed service area is the geographic area in which the home service provider (the facilities-based carrier or reseller with which the customer contracts for service) is authorized by law or contract to provide service to the customer. The bill also provides that the Tax Commissioner may adopt rules necessary to implement and administer this new sourcing provision, and may provide an electronic data base to be used by home service providers.

Reporting use tax on income tax return

(sec. 5747.083)

Currently, the state and county use taxes apply to purchases made outside Ohio if the property or service is used or consumed in Ohio. If the purchaser pays sales tax to the state where the purchase occurs, then use tax is due only to the extent that the state and county use tax is greater than the sales tax paid to the other state. Also under current law, the Tax Commissioner has the authority to prescribe the form of the personal income tax return. The return for 2000 included a line for reporting use taxes due on purchases made outside Ohio but not yet paid to Ohio.

The bill prohibits the Tax Commissioner from requiring a taxpayer to report or pay use tax on a purchase as part of the income tax return if the taxpayer already has paid sales tax to Ohio or another state when the purchase was made. Thus, for example, if a taxpayer were to purchase something outside Ohio and pay 4% sales tax to that other state, the taxpayer could not be required to report the additional 1% in Ohio tax (since the Ohio rate is 5%) or any county use tax on the income tax return.

Eliminate limited vendor license references

(R.C. 311.37, 311.99, 3715.52, 5739.31, and 5739.99(C)(3))

H.B. 612 of the 123rd General Assembly eliminated the limited vendor license class. Persons who had to obtain that license must now obtain a transient vendor or regular vendor's license. This bill eliminates residual references to limited vendors that are still in state law.

Reorganization of the lodging taxes

(R.C. 307.671, 307.672, 307.674, 307.695, 351.01, 351.021, 351.03, 351.141, 505.56, 4501.32, 5739.02, 5739.08, and 5739.09)

R.C. 5739.02(A) levies the state sales tax on transactions by which lodging by a hotel is furnished to transient guests. R.C. 5739.02(C) provides that the levy of the state sales tax on lodging does not prevent certain political subdivisions from also levying an excise tax on lodging. Those subdivisions may do so in accordance with R.C. 5739.024. The bill moves the R.C. 5739.02(C) provision to 5739.08, and renumbers 5739.024 as 5739.09, so that the lodging tax provisions are contained together in the Revised Code. This simplifies the lodging tax and also clarifies that, for purposes of the model act and interstate agreement, references to the tax levied by R.C. 5739.02 means solely the state sales tax, and does not also refer to the lodging taxes.

HISTORY

ACTION	DATE	JOURNAL ENTRY	
Introduced	06-28-01	p.	785
Reported, S. Ways and Means	10-03-01	pp.	931-932
Passed Senate (31-1)	10-03-01	p.	934
Reported, H. Ways and Means	---		---

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