Andre Imbrogno *Legislative Service Commission*

H.B. 407

125th General Assembly
(As Introduced)

Reps. Gibbs, Taylor, Husted, Raussen, Otterman, Schaffer, Grendell, Fessler, Aslanides, Martin, Blasdel, Faber, Collier, Flowers, Seaver, Gilb, Carmichael, Brinkman, McGregor, Daniels, D. Evans, Wolpert, Reidelbach, White, Distel, Webster, Wagner, J. Stewart

BILL SUMMARY

- Changes the new sales tax sourcing provisions scheduled to take effect January 1, 2005 (and enacted to implement the Streamlined Sales and Use Tax Agreement) to apply origin-based, instead of destination-based, rules to determine where remote sales are taxable.

- Prohibits the Tax Commissioner from petitioning for the state's membership in the Agreement unless the Agreement is amended to permit states to apply the bill's proposed sourcing rule.

- Prohibits the Tax Commissioner from petitioning for membership in the Agreement unless the Agreement is amended to permit states to provide certain qualified small businesses (businesses with out-of-state sales of $50,000 or less) and businesses without access to computer technology with a printed, tangible document that allows a business to identify where a sale is taxable.

- Prohibits the Tax Commissioner from petitioning for membership in the Agreement unless the Agreement is amended to permit states to allow a qualified small business that makes a sale that is taxable in another state with multiple local tax rates to apply the state's average tax rate.

- Prohibits the Tax Commissioner from petitioning for membership in the Agreement unless the Agreement is amended to permit states to allow qualified small businesses and businesses without access to computer technology to file monthly sales tax returns specifying the amount of taxes collected by the business for other states and to mail the return to the state's tax administrator for remittance to the appropriate state.

CONTENT AND OPERATION

Overview

The bill proposes further changes to a part of Ohio sales and use tax law that was enacted recently to coordinate Ohio law with the multistate Streamlined Sales and Use Tax Agreement (or "SST Agreement," explained below). The bill's changes affect the "sourcing" rules governing where a sale is deemed to occur. The sourcing rules enable sellers participating in the Agreement to determine the taxing jurisdiction where a sale is taxable, which in turn determines the appropriate tax rate and the appropriate recipient of the tax revenue. The bill changes the sourcing rules with respect to "remote" sales, where a person purchases property or a service from a seller and receives the property or service somewhere other than the seller's place of business; for example, when property is ordered by mail, over the telephone or internet, or even in person, and the property is delivered, or when a service is ordered and the service is performed off the service provider's premises.

The bill's changes to the sourcing rules are inconsistent with the Agreement's sourcing rules. Accordingly, the bill places a condition on Ohio's full implementation of the Agreement: before Ohio can become a member of the Agreement, the Agreement must be modified to allow member states to have sourcing rules such as those proposed by the bill. The bill also places other conditions relating to how, and to what extent, some businesses must comply with the Agreement. Until these conditions are satisfied, the bill prohibits the Tax Commissioner, as the state's representative, from formally seeking membership in the Agreement.

Streamlined Sales and Use Tax Agreement--background

Ohio is a participant in the Streamlined Sales Tax Project and is in the process of codifying the provisions of the Streamlined Sales and Use Tax Agreement ("Agreement") in state law. Once Ohio's sales tax laws, rules, regulations, and policies substantially comply with the Agreement's provisions, Ohio may petition the Streamlined Sales and Use Tax Governing Board for membership in the Agreement.

The Agreement implements a voluntary, multistate system intended to facilitate and simplify sellers' collection and payment of sales and use taxes. Among other things, the Agreement requires its member states to codify in their respective tax codes uniform standards for attributing the source of transactions to taxing jurisdictions (i.e., designating where a sale occurs). The designation of the

location of a sale determines the tax rate applied to the sale and also determines which local taxing jurisdiction will receive the tax revenue from the sale.

States apply for membership under the Agreement by submitting a petition and a certificate of compliance documenting the state's compliance with the provisions of the Agreement and citing applicable laws evidencing the state's compliance. Ohio will not have achieved substantial compliance with the terms of the Agreement until it implements the Agreement's uniform standards for attributing the source of transactions to taxing jurisdictions. Although Ohio enacted legislation implementing these uniform sourcing standards, implementation of the standards has been delayed until January 1, 2005.

Collection of sales and use taxes from out-of-state sellers: constitutional limitations

The United States Constitution's Commerce Clause, Art. I, § 8, cl. 3, bars states from collecting sales and use taxes from sellers located in other states unless those sellers have "substantial nexus" with the taxing state. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the United States Supreme Court held that an out-of-state seller does not have substantial nexus with a taxing state unless the seller maintains a physical presence in the state.[1]

The Agreement will remain a voluntary collection system with respect to sellers without physical presence nexus unless and until Congress dispenses with the physical presence nexus required under the United States Supreme Court's decision in *Quill*. Legislation authorizing states that are parties to the Agreement to compel remote sellers to collect and remit sales and use taxes for the state has been introduced in both chambers of Congress (H.R. 3184 and S. 1736). Both bills are currently in committee.

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[1] *Because the United States Congress has plenary authority over interstate commerce, Congress can effectively overrule the* Quill *holding by enacting legislation permitting states to require out-of-state sellers without physical presence nexus in the taxing state to collect sales and use taxes.* Quill, *504 U.S. at 318; Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 423 (1946).*

Sourcing rules for sales of tangible personal property and services

(R.C. 5739.033, 5740.05, and 5740.051; Streamlined Sales and Use Tax Agreement, Art. III, Section 310(A))

Agreement

Under the Agreement, member states must adopt uniform standards for attributing the source of transactions to taxing jurisdictions. These standards are used to determine where a sale occurs. The location of the sale in turn determines the tax rate that is applied to the sale and the taxing jurisdiction that will receive the tax revenue from the sale.

Current Ohio sourcing rule

Under current law, until January 1, 2005, sales of tangible personal property and services are generally sourced to the taxing jurisdiction where the seller's place of business is located (i.e., the "origin" of the sale), even if the property or service is received at a location away from the seller's place of business in this or another state. However, beginning January 1, 2005, Ohio law adopts the Agreement's sales tax sourcing provisions, so sales of property or services received at a location other than the seller's place of business (i.e., "remote sales") are sourced to where the property or service is received (i.e., the sale's "destination"). Because the sourcing standards determine which local taxing jurisdiction receives the taxes collected on a sale, Ohio's adoption of a destination-based standard for sourcing sales will result in changes in the distribution of sales tax revenue among Ohio's counties beginning January 1, 2005.

The bill's proposed sourcing rule

The bill proposes a sourcing rule different from the Agreement's sourcing rules and the rule scheduled to be implemented in Ohio beginning January 1, 2005. The difference affects only remote sales--those where property or services are received somewhere other than the seller's place of business. The bill's proposed rule allows some remote sales made by an Ohio-based seller to be sourced on the basis of where the sale originates (i.e., the seller's place of business) rather than where the destination of the sale is (i.e., where the property or service is received). The bill's origin-based rule applies to two kinds of remote sales: (1) where the origin and the destination are both in Ohio ("in-state sale"), and (2) where the origin is in Ohio but the destination is in another SST member state, and the other member state reciprocates by using an origin-based rule for remote sales originating in that state and destined for Ohio ("out-of-state sale"). Specifically:

- ***In-state sales:*** If the seller's place of business is in Ohio and the property or service is received somewhere else in Ohio, the sale is sourced to the seller's place of business, not the place where the property or service is received.

    - ***Example:*** If a sale is made by a seller in Madison County and the property or service is received in Fulton County, the sale will be sourced to Madison County, where the sale originates. (In contrast, under the rule to be implemented January 1, 2005, the sale would be sourced to Fulton County.)

- ***Out-of-state sales:*** If the seller is in Ohio and the property or service is received in another state, the sale is sourced to the place where the property or service is received, with one exception: the sale is sourced to Ohio if that other state is an SST member and it reciprocates by not sourcing a sale originating there to Ohio if the property or service were received in Ohio. In other words, Ohio can apply an origin-based sourcing rule to sales delivered to purchasers in another member state if that other state does not apply a destination-based rule to sales delivered to purchasers in Ohio.

    - ***Example:*** Assume Pennsylvania is an SST member state and does not employ a destination-based rule treating Ohio as the source of sales made by Pennsylvania-based sellers for delivery in Ohio. Under the bill's sourcing rule, Ohio will be the source of any sale made by an Ohio-based seller for delivery in Pennsylvania. On the other hand, if Pennsylvania were not an SST member, or if Pennsylvania employed an origination-based rule treating itself as the source of a sale originating with a Pennsylvania-based seller for delivery in Ohio, then Ohio will not be treated as the source of the sale.

Note: The examples assume that the Agreement would permit an SST member state to adopt an alternative sourcing rule like the one proposed by the bill. The Agreement currently does not permit such a rule.

The bill's proposed rule does not change the sourcing rules applying to sales where the property or service is received at the seller's place of business, or to the "fallback" rules, which apply when the seller does not know where the property or service is received and must rely on a purchaser's address or on the place where the shipment or service originated. The bill's sourcing rule would take effect

January 1, 2005, in lieu of the SST-coordinating rules scheduled to take effect on that date under existing law.

Corresponding change in Agreement

In addition to changing the sourcing rule for remote sales as described above, the bill prohibits the Tax Commissioner from petitioning for membership in the Agreement unless and until the Agreement is modified to permit a state to apply the proposed sourcing rule as an alternative to the Agreement's destination-based rule.

Special filing and remittance rules for small businesses and businesses without access to computer technology

(R.C. 5740.051; Streamlined Sales and Use Tax Agreement, Art. III, Sections 318 and 319)

Currently, the Agreement requires sellers to file returns and remit sales taxes directly to the member states on whose behalf the sellers collect the taxes, although a seller may rely upon a "certified service provider" to perform this and other sales and use tax functions on the seller's behalf.[2] The Agreement authorizes member states to require sellers to file electronic returns and make electronic remittances.

The bill prohibits the Tax Commissioner from petitioning for membership in the Agreement unless the Agreement is amended to allow states to impose different filing and remittance requirements for certain "qualified sellers" and sellers without access to the computer technology needed to make electronic filings and remittances. The bill defines a "qualified seller" as a seller that, in its most recently completed fiscal year, had out-of-state sales totaling no more than $50,000. In the case of a seller that has been in business for less than one year, the seller is a "qualified seller" until six months following the date on which the seller completes a quarter in which its total out-of-state sales exceed $12,500.

Under the bill, the Tax Commissioner is prohibited from petitioning for membership in the Agreement unless and until the Agreement does all of the

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[2] *Under the Agreement, the Governing Board certifies service providers in accordance with specific criteria set forth in the Agreement. A service provider cannot be certified by the Governing Board unless the service provider uses a certified automated system, which is software certified by the Governing Board for calculating sales and use taxes imposed by each jurisdiction, determining the amount of tax to remit to the appropriate state, and maintaining a record of each transaction. (R.C. 5740.01 and Streamlined Sales and Use Tax Agreement, Art. V.)*

following with respect to qualified sellers and sellers without access to computer technology:

(1) Permits a member state to allow a qualified seller that makes a sale sourced to a taxing jurisdiction located in another state with multiple local tax rates to apply the average of all of the various tax rates applied in that state;

(2) Does not prohibit a member state's state tax administrator[3] from providing qualified sellers, and sellers without access to the computer technology needed to electronically file returns and remit taxes, with a printed, tangible document that allows the seller to identify the tax rate to be applied to a sale using the United States Postal Service zip code of the local taxing jurisdiction to which the sale is sourced and, if the local taxing jurisdiction is located in another member state that has multiple local tax rates, the average of the various tax rates applied in that state;[4] and

(3) Does not prohibit a member state from permitting a qualified seller or a seller without access to computer technology to file a monthly return specifying the amount of taxes collected by the seller for member states and to mail the return, together with payment of the taxes, to the qualified seller's state tax administrator for remittance by the administrator to the member states on whose behalf the taxes were collected.

HISTORY

ACTION	DATE	JOURNAL ENTRY
Introduced	02-12-04	p. 1643

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[3] *The bill defines a "state tax administrator" as the state official or state agency charged with the responsibility of administering a member state's sales and use taxes (R.C. 5740.051(A)(4)).*

[4] *The Agreement requires each state to maintain a computer database that assigns each five digit and nine digit zip code within a member state to the proper tax rates and jurisdictions, which will allow sellers to identify the precise tax rate to be applied to any sale (Streamlined Sales and Use Tax Agreement, Art. III, Section 305(F)). Under the bill, unless a seller is a "qualified seller" or has no access to computer technology, the seller would use these computer databases to calculate sales and use taxes.*