*Bill Analysis*

*Bethany Boyd* *Legislative Service Commission*

# Sub. S.B. 218

125th General Assembly
(As Passed by the Senate)

**Sens. Amstutz, Goodman, Harris**

## BILL SUMMARY

- Requires the Tax Commissioner to work with states that are implementing the Streamlined Sales and Use Tax Agreement to encourage the adoption of an amendment that allows certain vendors to source sales at their places of business.

- Creates a six-month compensation mechanism for vendors to assist them in complying with the destination-based sourcing law that is scheduled to take effect July 1, 2005.

- Establishes a permanent compensation procedure for counties with a population of less than 75,000 and that have sales tax losses of at least 4% that pays them a portion of the sales tax revenues they lost due to destination-based sourcing.

- Creates the County Compensation Tax Study Committee to determine the extent to which each county is affected by destination-based sourcing.

- Adopts a customer refund procedure contained in the Agreement to be used by purchasers who are seeking a refund of over-collected sales or use taxes from sellers.

- Revises existing law to reflect a provision in the Agreement regarding confidentiality and privacy rights of consumers.

- Permits the Tax Commissioner to establish or participate in a registration system to issue vendors' licenses on behalf of counties.

- Makes other changes to comply with the Agreement.

## CONTENT AND OPERATION

### ***Overview***

The bill addresses Ohio's transition from origin-based sourcing to destination-based sourcing of sales made by vendors, which is scheduled to occur July 1, 2005. In conjunction with that transition, the bill requires the Tax Commissioner to work with states that are implementing the Streamlined Sales and Use Tax Agreement to encourage the adoption of an amendment that allows certain vendors to source sales at their places of business. The bill also establishes a six-month compensation mechanism for vendors for implementing destination-based sourcing. And finally, the bill enacts a permanent compensation procedure to give certain counties a portion of the sales tax revenues they lose due to destination-based sourcing, and creates a study committee to determine the extent to which each county is affected by destination-based sourcing.

To comply with the Streamlined Sales and Use Tax Agreement, the bill establishes a customer refund procedure to be used by purchasers who are seeking a refund of over-collected sales or use taxes from sellers, amends existing law regarding confidentiality and privacy rights of consumers, and permits the Tax Commissioner to issue vendors' licenses on behalf of counties as part of any registration system that the Commissioner establishes or in which the Commissioner participates.

### ***Determining where sales occur***

#### ***Background***

Under the sales tax law, determining where a sale occurs is important for returning tax revenues to counties and transit authorities. If a county or transit authority levies local "piggyback" sales taxes in addition to the state sales tax, a vendor collects the state and piggyback sales taxes from its customers in an amount that equals the total tax rate for the county, and pays the taxes to the state. The Tax Commissioner then determines each month the amount of piggyback taxes to be returned to the county or transit authority levying them.

For the majority of sales, determining where a sale occurred is easy, because most consumers purchase property and take possession of it at a vendor's place of business. In this instance, the vendor collects the sales tax from the consumer and pays it to the state, at the tax rate that exists for the county in which the vendor is located. But if the property is to be delivered to the consumer in another location, determining where the sale occurred is more difficult, and the vendor must follow state law to determine the "source" of the sale. Under the current sales and use tax sourcing law (R.C. 5739.033), if a consumer takes possession of the property other than at the vendor's place of business or takes possession at the vendor's warehouse, the law provides that the sale occurred at the vendor's place of business where the purchase contract or agreement was made or the purchase order was received. Sourcing sales in this manner is sometimes called "origin-based sourcing" because the law deems that the sale occurred at the vendor's place of business, i.e., the origin of the sale.

Am. Sub. S.B. 143 of the 124th General Assembly changed origin-based sourcing. S.B. 143 enacted the Simplified Sales and Use Tax Administration Act and authorized Ohio to participate in multi-state discussions to finalize a voluntary, streamlined sales tax collection system through a Streamlined Sales and Use Tax Agreement (the "Agreement") developed by the states. The Agreement provides that any state that becomes a member to the Agreement is authorized to collect taxes from remote sellers that have voluntarily registered with the central electronic registration system established under the Agreement. The Agreement requires that states bring their law, rules, regulations, and policies into substantial compliance with each of its provisions in order to become a member state.

One of the laws that must be revised for Ohio to become a member state is its origin-based sourcing law. The Agreement requires that all member states adopt uniform sourcing standards for retail sales so that it is easier for vendors to collect taxes for the proper taxing jurisdiction. These standards provide that sales are generally determined to be sourced to a vendor's place of business, but when tangible personal property or services are not received by a consumer at a vendor's place of business, the source of the sale is the location where the consumer received the property or services, and the taxes are collected and remitted by the vendor for that location, at the tax rate that exists in that location. The method to source sales under these standards is generally referred to as "destination-based sourcing." Ohio enacted these standards as part of S.B. 143, in its destination-based sourcing law, which was scheduled to take effect July 1, 2003. This effective date has been delayed a few times, most recently by Sub. H.B. 204 of the 125th General Assembly, which sets an effective date of July 1, 2005.

Once the destination-based sourcing law takes effect, it will change how tax dollars are returned to counties and transit authorities that levy local piggyback sales and use taxes, because the law revises how the location of a sale is determined and, more importantly, the county in which the sale occurred. Under destination-based sourcing, if a consumer purchases tangible personal property from a vendor in one county, but has the property delivered to another county, the tax to be collected is the tax rate of the county to which the delivery was made. That county is the source of the sale, and is the county levying the sales tax on the sale, not the county in which the vendor is located. In addition, the Tax Commissioner views that source county as the county in which the tax collections occurred for purposes of returning piggyback taxes to the county or transit authority levying them.

***Implementing destination-based sourcing***

(R.C. 5739.033, 5739.035, 5740.10, and 5741.05(A); Sections 3 to 9)

Under the bill, the origin-based sourcing requirements (R.C. 5739.035 in the bill) apply to sales made before July 1, 2005. The bill implements the destination-based sourcing law (R.C. 5739.033 in the bill) on July 1, 2005, but requires the Tax Commissioner to work with the states implementing the Agreement to amend the Agreement to allow origin-based sourcing for a person that holds a vendor's license and has limited Ohio taxable sales, as defined by the Commissioner. If the amendment is adopted or if this change in sourcing is otherwise allowed without amendment of the Agreement, the Commissioner must adopt a rule that excepts that type of vendor from destination-based sourcing, but that otherwise keeps Ohio in substantial compliance with the Agreement.

The bill provides that on and after January 1, 2005, any vendor may irrevocably elect to comply with the destination-based sourcing law for all of the vendor's sales and places of business in Ohio.

***Miscellaneous***

(R.C. 5739.034(E)(3))

The bill clarifies that mobile telecommunications service that is a prepaid telecommunications service must be sourced under the destination-based sourcing law to the address from which the service was provided, but in lieu of sourcing the sale in that manner, it may be sourced to the location associated with the mobile telephone number.

## ***Vendor compensation for implementing destination-based sourcing***

(R.C. 5703.70 and 5739.123)

The bill establishes a temporary compensation mechanism for vendors, as they begin to implement destination-based sourcing. A vendor who holds a vendor's license that is issued prior to July 1, 2005, may apply for temporary compensation to assist the vendor in complying with the destination-based sourcing law for the first six months that law applies to the vendor. The compensation is calculated for each county each month of the six-month period, and must equal the amount of the tax reported on the vendor's return for sales of tangible personal property delivered to each county in which the vendor does not have a fixed place of business and does not, or is not required to, hold a vendor's license for that business.[1] The compensation cannot exceed $25 per county for each month. Only amounts paid by the vendor for which the vendor is eligible for a discount for early payment of sales taxes and that are shown on returns filed during that six-month period are to be considered in calculating the compensation. In no event is a vendor to receive compensation that exceeds its total cost of complying with the destination-based sourcing law.

The vendor must file an application for compensation with the Tax Commissioner on a form prescribed by the Commissioner, within 60 days after the last day of the last month of the six-month period for which the vendor is requesting compensation. The Commissioner is required to determine the amount of compensation to which the vendor is entitled, and if that amount is equal to or greater than the amount claimed on the application, the Commissioner must certify that amount to the Director of Budget and Management and the Treasurer of State for payment from the General Revenue Fund. If the Commissioner determines that the amount of compensation to which the vendor is entitled is less than the amount claimed on the vendor's application, the Commissioner must proceed in accordance with existing law (R.C. 5703.70) that sets forth notice and hearing procedures for applying for tax refunds when the amount of a refund is in dispute.

The bill provides that the additional vendor compensation is not to reduce the amount of revenue that is required to be returned each month to counties and transit authorities that levy piggyback taxes.

## ***County compensation for implementing destination-based sourcing***

### ***Calculation of the compensation***

(R.C. 5739.24(A), (B)(1), and (C) to (F))

The bill establishes a permanent procedure to compensate counties that are "impacted counties," i.e., those with a population of less than 75,000 people as of the 2000 decennial census taken by the United States Census Bureau, and that incur sales tax losses of at least 4% when they implement destination-based sourcing. The money to compensate these counties comes from "windfall counties" that collect additional sales taxes due to destination-based sourcing.

Within 30 days after June 30 and December 31 of each year, a "master account holder" that makes any sale that is subject to the destination-based sourcing law must file with the Tax Commissioner a report that details the total taxable sales it made for the prior six-month period in each tax jurisdiction, and at each fixed place of business for which the master account holder holds or should

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[1] *A partial month is considered a month.*

hold a license, irrespective of where those sales were sourced under that law.[2] A "master account holder" is a person that holds more than one vendor's license for a fixed place of business, operates in multiple tax jurisdictions under the same ownership, and files or is required to file a consolidated sales tax return. A "tax jurisdiction" is a county or, if applicable, the portion of a county in which a transit authority has territory.

Within 75 days after June 30 and December 31 of each year, the Commissioner must determine for each county both of the following:

(1) The amount of county piggyback sales taxes paid by all vendors that hold a vendor's license for a fixed place of business and that were collected by the county in accordance with the destination-based sourcing law;

(2) The amount of county piggyback sales taxes that would have been paid to the county by those vendors if the taxes had been collected by the county under the origin-based sourcing law.

In making this determination, the Commissioner must use the lesser of the county's tax rate in effect as of January 1, 2005, or the actual tax rate in effect for the six-month period for which the compensation was calculated. The bill permits the Commissioner to make any adjustments that are necessary to account for delinquent tax returns or reports.

After making the determinations in (1) and (2), above, the Commissioner then must calculate the percentage difference between the amounts determined under (1) and (2) by using a fraction, with the amount determined under (1) in the numerator, and the amount determined under (2) in the denominator.[3] If a county is an impacted county and the percentage difference for the county is 96% or less (or, stated differently, the county incurs a sales tax loss of 4% or more), the county is entitled to compensation under the bill. Within 90 days after June 30 and December 31 of each year, the Commissioner, in the next ensuing payment made to return piggyback taxes to the county, must in addition provide to the county from the General Revenue Fund, compensation in the amount of 98% of the denominator of the fraction calculated above, minus the numerator of the fraction calculated above. A county that is entitled to this compensation may request an advance payment. The bill requires the Commissioner to adopt rules that establish the manner by which a county may make such a request and the method the

[2] *The Commissioner may extend the time for filing the report.*

[3] *The bill requires that the Tax Commissioner make these determinations available to the public, but any data obtained from taxpayers under the bill or that would identify those taxpayers must remain confidential.*

Commissioner will use to determine the amount of the advance payment to be made to the county. The compensation a county receives is to be adjusted accordingly to account for any advance payments.

If the Commissioner determines under (1) and (2), above, that a county collected more taxes under the destination-based sourcing law than it would have collected if taxes had been paid under the origin-based sourcing law, the county is a windfall county. Within 90 days after June 30 and December 31 of each year, the Commissioner, in the next ensuing payment made to return piggyback taxes to the county, must reduce the amount to be returned to each windfall county by the total amount of excess taxes that would have been received by all windfall counties in proportion to the total amount needed to compensate the impacted counties that incurred a sales tax loss of 4% or more.

***Failure to file the report***

(R.C. 5739.24(B)(2))

If a master account holder does not file a report in timely fashion, the Commissioner must mail notice of the delinquent report to the master account holder. In addition to any other penalties or additional charges imposed under the sales tax law, the Commissioner may impose a penalty of up to $50 for each fixed place of business of the master account holder. If the report is filed within 15 days after the Commissioner mails the delinquency notice, the Commissioner may remit the penalty in full or in part. But if the master account holder fails to file the report within 15 days after the Commissioner mails the delinquency notice, the Commissioner must impose a penalty of up to $100 for each fixed place of business of the master account holder. This penalty may not be remitted in full by the Commissioner. A penalty is subject to collection and assessment in the same manner as a sales tax liability.

***County Compensation Tax Study Committee***

(R.C. 5739.24(G))

The bill creates the County Compensation Tax Study Committee. The Committee consists of the following seven members: the Tax Commissioner, three members of the Senate appointed by the President of the Senate, and three members of the House of Representatives appointed by the Speaker of the House of Representatives. The appointments are to be made not later than January 31, 2006. The Tax Commissioner is the chairperson of the Committee and the Department of Taxation is required to provide any information and assistance the Committee requires to carry out its duties. The Committee is to study the extent to which each county has been impacted by destination-based sourcing. Not later than June 30, 2006, the Committee is to issue a report of its findings and make recommendations to the President of the Senate and Speaker of the House of Representatives, at which time the Committee ceases to exist.

***Changes made to comply with the Streamlined Sales and Use Tax Agreement***

***Customer refund procedures under the Agreement***

(R.C. 5740.09)

The Agreement contains a provision that establishes a customer refund procedure to be used by purchasers who are seeking refunds of over-collected sales or use taxes from "sellers" (persons making sales, leases, or rental of personal property or services). Ohio law currently does not address this procedure.

The bill enacts this procedure to comply with the Agreement. The bill provides that no cause of action accrues against a seller for over-collection of the state sales and use taxes and local piggyback sales and use taxes until the purchaser has provided written notice of the over-collection to the seller and the seller has had 60 days after the notice was mailed to respond. The notice "must contain the information necessary to determine the validity of the request." No cause of action accrues against a seller for the over-collection of sales and use taxes if either the purchaser or the seller has filed a refund claim for the over-collection under the existing refund laws for sales and use taxes.

In connection with a purchaser's request from a seller of over-collected sales and use taxes, the bill provides that a seller is presumed to have a reasonable business practice if, in the collection of the taxes, the seller uses either a certified service provider or a certified automated system, including a proprietary system, and has remitted to the state all sales and use taxes collected, less any deductions or collection allowances (including vendor discounts for early payment provided under existing law). Under existing law, a "certified service provider" is an agent certified jointly by the member states to perform all of the seller's sales and use tax functions. A "certified automated system" is software certified jointly by the member states to calculate the sales or use tax imposed by each jurisdiction on a transaction, determine the amount of sales and use tax to remit to the appropriate state, and maintain a record of the transaction.

***Confidential taxpayer information***

(R.C. 5740.08)

The Agreement also contains a provision that addresses the confidentiality rights of all participants in the Agreement and the protection of the privacy interests of consumers who deal with sellers that have selected a certified service provider as their agent. Ohio enacted the confidentiality and privacy provision in 2002, but the bill modifies that law to more closely reflect changes that have since been made to the Agreement.

Continuing law requires that if a seller uses a certified service provider to collect and remit its sales and use taxes, the certified service provider must preserve the privacy of consumers and protect consumer information. The bill requires that the provider protect the "personally identifiable information" of the consumer, and defines it as "information that identifies a person."

Current law requires that a certified service provider provide to consumers 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 (states that are signatories to the Agreement). The bill requires that the Tax Commissioner, rather than the certified service provider, notify consumers of the Commissioner's information retention and sharing practices, including what personally identifiable information the Commissioner collects, how the information collected is used, how long the information is retained, and whether the information is disclosed to other states. The bill also provides that when the Commissioner retains a consumer's personally identifiable information that the Commissioner received from a certified service provider, the Commissioner must allow the consumer to examine that information and correct any inaccurately recorded information.

Current law also provides that if any person, other than a member state, seeks to discover a consumer's personally identifiable information, a certified service provider must make a reasonable and timely effort to notify the consumer of the request. The bill changes this by requiring that if any person, other than a member state or a person otherwise authorized by the laws of Ohio, seeks to discover a consumer's personally identifiable information, the Tax Commissioner must make a reasonable and timely effort to notify the consumer of the request.

Continuing law provides that the laws of Ohio regarding the collection, use, and maintenance of confidential taxpayer information remain applicable and binding, and that the Agreement does not enlarge or limit Ohio's authority to do certain things, including collecting, disclosing, disseminating, or otherwise using anonymous data for governmental purposes. The bill defines "confidential taxpayer information" as all information that is protected under Revised Code Title 57 (Taxation) or other applicable law, and defines "anonymous data" as information that does not identify a person.

***Vendor licensing***

(R.C. 5739.17)

Continuing law requires that an applicant for a vendor's license deliver to the county auditor of each county in which the applicant desires to engage in business an application for the license and a $25 license fee. The county auditor issues the license and deposits the fee in the county treasury.

The bill provides that the Tax Commissioner may establish or participate in a registration system whereby any vendor may obtain a vendor's license by submitting to the Commissioner a vendor's license application and a $25 license fee for each fixed place of business at which the vendor intends to make retail sales. Under this registration system, the Commissioner must issue the vendor's license to the applicant on behalf of the county auditor of the county in which the applicant desires to engage in business, and must forward a copy of the application and license fee to that county.

***Elimination of study date***

(R.C. 5740.05)

Current law provides that the Tax Commissioner cannot enter into the Agreement unless the Agreement contains certain requirements. One of those requirements was that the Agreement allow for a joint and public 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. The bill removes the reference to the date, because the study was not completed by that time.

## HISTORY

| ACTION | DATE | JOURNAL ENTRY | |
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| Reported, S. Ways & Means & Economic Development | 12-01-04 | p. | 2345 |
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