
Detailed Fiscal Analysis

Repeal of destination-based sourcing for intrastate sales

Ohio's sales and use tax sourcing rules have been amended occasionally over the preceding several years in an effort to conform Ohio's rules to the sourcing rules of the multi-state Streamlined Sales and Use Tax Agreement (SSUTA).

Until recently, the SSUTA required destination-based sourcing, where a sale generally occurs where the customer receives the goods or services. Under origin-based sourcing, a sale generally occurs where the vendor is located or the order is received. In December 2007, the SSUTA was amended to permit member states with local taxing jurisdictions (such as Ohio) to apply origin-based sourcing to transactions occurring within the state (i.e., when a sale is made by a vendor in the same state where the purchaser receives the property or service). It appears the new SSUTA amendment does not apply to inter-state transactions, i.e., destination-based sourcing will continue to apply to those sales.

Vendors with delivery sales below \$30 million were allowed to continue sourcing sales under the origin-based sourcing system through December 31, 2007 (H.B. 294, 126th General Assembly, and H.B. 119, 127th General Assembly). Beginning in January 2008, vendors with annual delivery sales of \$500,000 or less were permitted to apply origin-based sourcing to taxable sales if the Tax Commissioner made a finding that the SSUTA permitted the continuation. The bill authorizes vendors, regardless of the size of their delivery sales, that had not yet converted to destination-based sourcing to continue to use origin-based sourcing. Thus, the bill reverses previous sourcing rules for taxable sales where both the customer and the seller are located in Ohio. More specifically, the bill requires all vendors to revert back to using origin-based sourcing for all intrastate sales as soon as possible. However, the change has to occur on the first of the month. Also, all vendors must use origin-based sourcing beginning January 1, 2010. Under continuing SSUTA rules, for sales by an out-of-state seller to an Ohio customer, destination-based sourcing rules (and Ohio use tax laws) would continue to apply. For sales by an Ohio seller to an out-of-state buyer, destination-based sourcing rules would continue to apply.

New vendor compensation program

Under the bill, the Tax Commissioner is authorized to devise and implement a plan to compensate vendors that had adopted destination-based sourcing under prior enactments and are required to convert back to origin-based sourcing for intrastate transactions. For vendors that were previously required to switch to destination sourcing, the compensation shall be their actual costs not to exceed \$1,000. For vendors who had switched voluntarily, the compensation would be up to \$600.

Vendor refunds to consumers

Under current law, when a vendor refunds to the consumer the full price of a returned item for which the sales and use tax has been paid, the vendor must also refund the full amount of the tax paid. The bill specifies that if a vendor refunds the price of an item minus any separately stated delivery charges, the vendor shall also refund the amount of tax paid on the item, minus the amount of tax attributable to the delivery charge.

Repeal of the county compensation program

Under current law, counties with a 2000 census population of less than 75,000 people (designated "impacted counties") that incur sales tax revenue losses of at least 4% due to the implementation of destination-based sourcing are entitled to compensation from the General Revenue Fund. The compensation is paid from sales and use tax revenue received by other counties ("windfall counties") experiencing revenue gains from the conversion.

The Tax Commissioner must determine the amount of sales tax revenue collected in a county in accordance with the destination-based sourcing law and compare that amount to the revenue the county would have received if the origin-based sourcing law had applied. If a county is an impacted county and the amount the county would have received under origin-based sourcing is at least 4% greater than the amount it actually received under destination-based sourcing, the county is entitled to compensation in such an amount that it would receive 98% of the estimated revenue it would have received under origin-based sourcing. If the Commissioner determines 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's monthly sales and use tax disbursement is reduced.

Based on information provided by the Tax Department, several counties had losses due to the change to destination-based sourcing for sales, and Holmes County was the only county that received compensation under current law. The bill terminates the compensation for impacted counties, the required offsets for windfall counties, and all related vendor-reporting requirements effective May 1, 2009.

Fiscal effect

The overall fiscal effect of the bill on state and local government revenues is expected to be minimal. The bill does not generally change total sales tax collections, although it potentially redistributes sales tax collections between counties. The bill would affect counties differently based on the relative number of vendors with delivery sales within the county, the net inter-county flows of delivery sales and associated tax collections, and the number of vendors with delivery sales who revert to origin-based sourcing. The fiscal impact of the bill on each county would depend on all those variables.

Depending on the number of vendors who revert to origin-based sourcing, the bill might increase revenue from the local permissive and additional sales taxes to certain counties (including impacted counties), which previously had losses from destination-based sourcing. Conversely, the bill might reduce revenues from certain windfall counties that had gains from destination-based sourcing.

LSC assumes that for certain counties that had losses from destination-based sourcing, the bill would reduce or eliminate the revenue loss. For another group of counties, the bill may reduce or eliminate the gain from destination-based sourcing. For the last group of counties, the bill may have no effect on tax revenues. LSC is unable to determine the impact of the bill on each individual county. Also, LSC assumes that elimination of the county compensation program would not adversely impact Holmes County as the revenue gain from the bill may offset compensation received under current law.

Vendors that were required by law to adopt in previous years destination-based sourcing for delivery sales were paid about \$110,000 under a prior vendor compensation program. The plan to implement a new compensation program for vendors that are required by the bill to convert back to origin-based sourcing may increase GRF expenditures. LSC assumes that the compensation will be paid from the General Revenue Fund. The timing and the size of the potential increase in GRF expenditures are uncertain.

Generally, when a customer returns purchased items, vendors refund to customers all or part of the tax paid by them. Then, vendors request refunds from the state of taxes remitted on transactions taxable under the sales tax. The bill specifies that whenever a vendor refunds to a customer the tax paid on the item, the vendor shall refund the tax paid on the item, but not the tax paid on the delivery charges if separately stated. Currently, when the vendor does not fully refund the customer (for example when the vendor does not refund a delivery charge associated with a taxable purchase), the vendor may not receive a sales tax refund from the state on the item that was returned. It appears the bill allows a sales tax refund when the vendor does not refund the delivery charge. As a result, the bill would qualify more refund requests for moneys to be paid by the state. Thus, the bill potentially creates a revenue loss to the GRF. The amount of revenue decrease from such cases is indeterminate.

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