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## ***Detailed Fiscal Analysis***

Under current law, a vendor that sells a taxable good or service to a person is required to collect the Ohio sales tax and any sales or use tax imposed by the state and the county or transit authority where the sale is deemed to be taxable under "situs" or sourcing rules. Since 2003, vendors have been required to use a new set of sourcing rules called destination-based sourcing for determining where a sale is taxable. Under these rules, a sale generally is taxable where the consumer takes possession of the goods, at the consumer's address, or where the service is performed. Because the destination-based sourcing rules do not assign the tax to the point of sale, a vendor selling to multiple taxing jurisdictions (including other states) must determine the use tax rates of those other jurisdictions. To assist vendors with this effort, the Streamlined Sales and Use Tax Agreement (SSTA) authorizes vendors to use certified service providers, which calculate the appropriate tax, collect it, and remit it to the appropriate state on the vendor's behalf.

To provide time for vendors to convert to the destination-based sourcing rules and for certified service provider services to be established, Ohio law provided a transition period. The general deadline for conversion to the destination-based rules was May 1, 2006, subject to a significant exception: for vendors whose sales to consumers in other jurisdictions are less than \$30 million per year, the deadline to start the new sourcing rules was extended until December 31, 2007.

Under current law, the Department of Taxation calculates for each county permissive sales tax receipts that would have been collected from most Ohio vendors on an origin basis (vendor location) compared to actual collections from permissive sales and use taxes. The law allows certain counties to obtain some reimbursement for the tax loss incurred as a result of destination-based sourcing. The reimbursement reduces the loss for an "impacted" county to only a 2% loss from the sourcing change. Counties gaining permissive sales and use tax revenues from destination-based sourcing provide the compensation to the impacted counties.<sup>1</sup>

### **Substitute Senate Bill 160**

The bill proposes an amendment to the destination-based rules, which may or may not be adopted by the STTA. The amendment suggests that vendors with delivery sales below \$500,000 may continue origin-based sourcing. If the Tax Commissioner determines that Ohio is not in compliance with the SSTA, all vendors that have not already converted to destination-based situs may continue to use origin-based rules. Vendors can switch to destination-based sourcing for delivery sales if they wish, but they cannot switch back. Vendors that have already converted to destination-based sourcing by the date of the Tax Commissioner's determination must continue to use destination-based sourcing. The

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<sup>1</sup> Based on sales and use tax receipts from July 1, 2006 through December 31, 2006, 19 counties had a tax loss from destination-based sourcing, ranging from \$680 to \$879,000. To receive reimbursement for the tax loss, a county must have a population of less than 75,000 and the loss must be at least 4% of the tax it would have received under origin-based sourcing compared to destination-based sourcing.

Tax Commissioner must make the determination, and enter it in the journal on or before October 1, 2007, and must inform vendors/sellers reasonably believed to be affected.

**Sourcing rules for in-state vendors**

If the Tax Commissioner determines that Ohio is in compliance with the SSTA (meaning that the SSTA permits vendors with annual in-state delivery sales of less than \$500,000 to use origin-based situsing), then Ohio vendors with annual in-state delivery sales of less than \$500,000 may use origin-based situsing. In a delivery sale, if the tax in the jurisdiction where the purchaser receives the goods is less than the tax in the jurisdiction where the vendor is located, the purchaser is entitled to a refund equal to the difference. If the tax in the jurisdiction where the purchaser receives the goods is more than the tax in the jurisdiction where the vendor is located, the purchaser is liable for the additional tax. The vendor must provide a notice in the invoice that the purchaser may be entitled to a refund or be liable for additional tax under the circumstances described above. Also, in any sale, if the purchaser receives the goods in one jurisdiction, and then removes them to a jurisdiction with a higher tax rate than the other jurisdiction, then the purchaser is liable for an amount equal to the difference.

If a vendor has in-state delivery sales for a calendar year that exceed \$500,000, the vendor must switch to destination-based situsing. If a vendor fails to provide one of the notices above, the vendor must switch to destination-based sourcing immediately. Also, any vendor can switch to destination-based situsing, but can't switch back.

**Sourcing rules for out-of-state sellers**

Out-of-state sellers with annual Ohio delivery sales of less than \$500,000 may elect to collect Ohio use tax at a single uniform rate (state rate plus lowest combined local rate, county or transit authority). If the purchaser receives the goods in one jurisdiction, and then removes them to a jurisdiction with a higher tax rate than the first jurisdiction, then the purchaser is liable for an amount equal to the difference. The seller is required to provide the additional liability notice, but there is no consequence for out-of-state sellers for not doing so. Revenue collected at the Ohio single rate is credited to the General Revenue Fund and distributed to counties and transit authorities pursuant to a formula. If the out-of-state seller goes over \$500,000 in a calendar year, then tax collections must be done at the varying county or transit authority use tax rates. All other vendors with delivery sales above \$500,000 must switch to destination-based situsing by January 1, 2008.

The bill provides for the distribution of tax receipts collected at a uniform rate from out-of-state sellers to counties and transit authorities that levy a use tax. The percentage to be distributed equals the total sales and use tax revenue distributed to counties and transit authorities in the calendar year that ended in the preceding fiscal year, divided by the sum of the total sales and use tax revenue distributed to those counties and transit authorities in that calendar year plus the total revenue collected in that calendar year from the state sales and use taxes.

From the amount required to be distributed to all counties and transit authorities each year, the bill requires each county and transit authority to receive quarterly distribution of a percentage of the total yearly distribution. The percentage equals the total sales and use tax revenue distributed to the county

or transit authority in the calendar year that ended in the preceding fiscal year, divided by the total sales and use tax revenue distributed to all counties and transit authorities in that calendar year.

With respect to all other revenue generated by local use taxes, the bill requires all revenue to be first credited to the General Revenue Fund. From the General Revenue Fund, the funds are transferred to the Local Sales Tax Administrative Fund and the Permissive Tax Distribution Fund according to current law. From the Permissive Tax Distribution Fund, revenues are distributed to local tax jurisdictions according to current law.

### **Fiscal impact**

#### **Direct effect**

The bill has no direct fiscal effect on state revenue. However, the bill may create local indirect effects as certain businesses change the siting of taxation of goods and services sold.

The bill creates a hybrid system for in-state vendors where both an origin-based sourcing system and a destination-based sourcing system for siting sales for tax purposes coexist. In-state vendors with delivery sales below \$500,000 per year would continue origin-based sourcing. Vendors with delivery sales above the threshold would have to convert to destination-based sourcing if they have not done so. Allowing certain vendors to continue and allowing others to revert to origin-based sourcing may result in both gains and losses to local jurisdictions as the tax location of certain sales may shift from vendor outlets to where sales are delivered, or from where sales are delivered to the point of purchase of goods and services. Generally, most sales are taxed at the rate in effect at the point of sale (customer leaves the business location with the item) or the items are delivered within the same taxing jurisdiction. For such sales, the bill would have no fiscal effect. However, whenever the location of the sale and the delivery are in different counties, although the state rate is the same, local sales tax rates may be different. When this shifting occurs, an individual local jurisdiction may incur a net revenue gain or loss depending on the value of purchases at businesses inside its boundaries and delivered elsewhere, the value of purchases by its residents in other jurisdictions and delivered at their residences, and whether the vendors apply origin-based or destination-based sourcing rules. Thus, the bill generally affects the redistribution of certain sales tax revenues to local governments, but does not substantially change the total amount of revenue collected by all local governments within the state. The magnitude of the potential shifting of taxable sales, and the net fiscal effect on various jurisdictions is indeterminate.

#### **Potential future indirect effects**

The elimination of the requirement for all vendors to convert to destination-based sourcing might prevent Ohio from becoming a party to the Streamlined Sales and Use Tax Agreement and a full member of the Streamlined Sales Tax Governing Board. Unless amended, destination-based sourcing of all taxable purchases is required under Section 310 of the Agreement. If Ohio is excluded from the SSTA, the use tax (imposed on Ohio residents when they make remote purchases outside Ohio) may not be collected and remitted to Ohio if remote vendors (located in other states) choose not to apply destination-based sourcing for Ohio purchases because the state is not a member of the SSTA. Thus, Ohio may potentially forego the benefit of the SSTA and potential revenue gains from the taxation of

certain remote sales. However, if Ohio remains a member of the SSTA, the bill may increase future collections from the state and local use taxes.

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