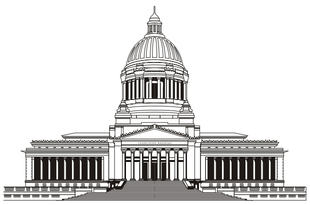
## Streamlined Sales Tax Mitigation

### Report 11-1

January 5, 2011



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# REPORT SUMMARY

## Why a JLARC Study of Streamlined Sales Tax Mitigation?

In 2007, the Legislature enacted legislation (SSB 5089) to conform Washington's tax laws to the Streamlined Sales and Use Tax Agreement (SSUTA). The SSUTA is a multistate compact intended to simplify and standardize state tax laws and facilitate sales tax collection on interstate transactions. The Legislature also enacted provisions to ***mitigate*** the negative impacts this legislation had on local taxing jurisdictions.

In this same legislation, the Legislature directed the Joint Legislative Audit and Review Committee (JLARC) to review these mitigation provisions in 2010. The purpose of this study is to determine the extent to which these mitigation provisions compensate local jurisdictions that experienced a loss in local sales tax revenue.

## Streamlined Sales Tax Impacts Local Jurisdictions

Washington became a full member of the SSUTA on July 1, 2008. Membership impacted the local sales tax collections of 364 local taxing jurisdictions, which include cities, counties, and transit districts. SSUTA membership had two primary effects on local sales tax collections:

1. Membership brings in new sales tax revenue from out-of-state retailers that had registered under the SSUTA. These retailers agreed to collect and remit sales tax on interstate sales to SSUTA member states. Since these retailers voluntarily register under the SSUTA, the sales tax they remit is known as ***voluntary compliance revenue***.
2. Membership required changes to Washington's sales tax sourcing laws. ***Sourcing*** laws determine the taxable location of a sale and which jurisdiction receives local sales tax. Prior to the SSUTA, Washington retailers sourced sales based on a delivery's point of ***origin***. For example, a couch delivered from a warehouse in Kent to a home in Seattle was sourced to Kent, and Kent received the local sales tax. In contrast, full members of the SSUTA must use the ***destination*** of a sale as the sales tax source. Thus, Seattle now receives local sales tax for the same transaction.

While the new voluntary compliance revenue benefited all local taxing jurisdictions, the change in sourcing laws shifted the distribution of local sales tax around the state. This shift meant that some local jurisdictions experienced a net gain or loss in sales tax revenue.

## Legislature Enacted Provisions to Mitigate Negative Impacts to Local Jurisdictions

The Legislature enacted provisions to mitigate the loss some jurisdictions experienced due to the change in sourcing laws. The Legislature directed the Department of Revenue to determine each local jurisdiction's losses by comparing businesses' tax return data from before and after the sourcing change. These losses are reduced by any voluntary compliance revenue a jurisdiction receives. The Legislature directed the State Treasurer to distribute a payment to each jurisdiction equal to any remaining net loss. The state agencies have followed the statutory requirements.

## Mitigation Payments and New Revenue Lower Than Expected

The actual cost of the mitigation payments is lower than expected, compared to the fiscal note prepared for the Legislature as it considered the bill in 2007.

**Exhibit 1 – Mitigation Payments and New Revenues Lower Than Expected (Dollars in Millions)**

| | Fiscal Year 2009 | | Fiscal Year 2010 | |
|---|---|---|---|---|
| | Fiscal Note | Actual | Fiscal Note | Actual |
| Mitigation Payment Costs | $31.6 | $21.4 | $41.5 | $26.1 |
| Voluntary Compliance Revenue | $49.1 | $5.6 | $59.0 | $7.1 |

Source: JLARC analysis of data from the Department of Revenue.

## Extent to Which Provisions Mitigate Negative Impacts Is Unclear

Data is not currently available to ascertain what local sales tax revenues local jurisdictions would have actually received if Washington had continued under origin-based sourcing. Absent this information, it is not possible to determine the exact extent to which the mitigation provisions have compensated local jurisdictions for the losses that are due to the state's participation in the SSUTA. To collect such information would require businesses to track and report the location of both the origin and destination of all of their deliveries.

## Mitigation Provisions May Not Reflect All Losses Over Time

Even assuming an accurate estimate of local losses, JLARC identified three consequences of the mitigation provisions that the Legislature has not explicitly addressed. First, the estimate of losses in past quarters differs from updated estimates, but there is no retroactive adjustment for past payments. Second, future mitigation payments will not reflect losses experienced by jurisdictions in future years. Finally, alternate provisions for public facilities districts to increase their tax rates do not fully mitigate annual losses experienced by the Kent Public Facilities District.

## No Other States Have Mitigation Provisions

While no other states have mitigation provisions, it is unlikely that any other SSUTA full member states faced the same magnitude of negative impacts to local jurisdictions from changing to destination-based sourcing. States that face similar challenges as Washington have elected to delay changing to destination sourcing and remain associate members.