

Department of Revenue Fiscal Note

Bill Number: 5541 SB	Title: Electronic commerce taxation	Agency: 140-Department of Revenue
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Part I: Estimates

☐ No Fiscal Impact

Estimated Cash Receipts to:

Account	FY 2016	FY 2017	2015-17	2017-19	2019-21
GF-STATE-State 01 - Taxes 01 - Retail Sales Tax	4,233,000	4,488,000	8,721,000	8,248,000	6,668,000
Performance Audits of Government Account-State 01 - Taxes 01 - Retail Sales Tax	6,000	7,000	13,000	14,000	11,000
Total \$	4,239,000	4,495,000	8,734,000	8,262,000	6,679,000

Estimated Expenditures from:

	FY 2016	FY 2017	2015-17	2017-19	2019-21
FTE Staff Years	3.7	3.4	3.6	3.4	3.3
Account					
GF-STATE-State 001-1	315,100	259,000	574,100	507,700	499,800
Total \$	315,100	259,000	574,100	507,700	499,800

Estimated Capital Budget Impact:

NONE

This bill was identified as a proposal governed by the requirements of RCW 43.135.031 (Initiative 960). Therefore, this fiscal analysis includes a projection showing the ten-year cost to tax or fee payers of the proposed taxes or fees.

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

- ☒ If fiscal impact is greater than \$50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.
- ☐ If fiscal impact is less than \$50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).
- ☐ Capital budget impact, complete Part IV.
- ☐ Requires new rule making, complete Part V.

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Request # 5541-1-1

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

PART 1: SALES AND USE TAX EXEMPTIONS FOR DIGITAL AUTOMATED SERVICES USED SOLELY FOR BUSINESS PURPOSES

Part I of this proposal provides a sales and use tax exemption for digital automated services used solely for business purposes. The purpose of this provision is to reaffirm and restore the policy choice the Legislature made in 2009 of providing substantial sales and use tax relief to businesses for their acquisition of digital business inputs. Like the original exemption for digital goods used solely for business purposes, this new exemption is not subject to an expiration date or accountability reporting.

PART II: CLARIFYING THE SALES AND USE TAX EXEMPTION FOR MACHINERY AND EQUIPMENT USED IN MANUFACTURING, RESEARCH AND DEVELOPMENT, OR TESTING OPERATIONS

Part II of this proposal clarifies that machinery and equipment used directly in the development of electronically-delivered prewritten computer software qualifies for the M&E exemption when all applicable requirements of the exemption are met.

Software developers that created and produced prewritten computer software delivered to consumers via a tangible medium have historically qualified for the sales and use tax exemption for machinery and equipment used by a manufacturer directly in a manufacturing or R&D operation (commonly referred to as the M&E exemption). Changes in the software industry have resulted in most prewritten computer software sold today being delivered to buyers electronically.

PART III: REMOTE SELLERS

Part III of this proposal provides greater clarity for certain out-of-state sellers by providing clear statutory guidelines for determining when they are required to collect Washington's retail sales or use tax and are subject to business and occupation (B&O) taxes.

Specifically, Part III of the bill:

1. Establishes "click-through" nexus provisions, which provide that remote sellers are presumed to have a substantial nexus with this state for sales and use tax collection purposes if:

- They have relationships with in-state persons who refer potential customers to the remote seller through links on websites or otherwise; and
- Sales to purchasers in this state under those relationships exceed \$10,000 in the preceding calendar year.

This presumption may be rebutted by proof that the resident with whom the remote seller has an agreement did not engage in any solicitation in this state on behalf of the remote seller that would satisfy the nexus requirement of the United States constitution during the calendar year in question.

2. Provides that if a remote seller has click-through nexus for sales and use tax collection purposes, it will also have nexus for B&O tax purposes for its selling activities.

3. Accommodates future changes in federal law or the Streamlined Sales and Use Tax Agreement (SSUTA) by:

- Effectively expiring any of the nexus provisions in Part III of the bill if the Department determines that they are in

conflict with any future change in federal law or the SSUTA.

- Allowing the Department to adopt rules under the Administrative Procedure Act that impose sales and use tax collection obligations to the fullest extent allowed under state and federal law.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

PART 1: SALES AND USE TAX EXEMPTIONS FOR DIGITAL AUTOMATED SERVICES USED SOLELY FOR BUSINESS PURPOSES

ASSUMPTIONS

- DAS use is assumed to grow at rates varying from 8 to 25 percent annually depending on the seller and on the year.
- Use tax compliance is assumed to be low, but sales tax compliance for Washington registered taxpayers is assumed to be high.

REVENUE IMPACT - Part 1

State Government (cash basis, \$000):

FY 2016 -	(\$10,218)
FY 2017 -	(\$12,038)
FY 2018 -	(\$13,001)
FY 2019 -	(\$14,041)
FY 2020 -	(\$15,164)
FY 2021 -	(\$16,377)

PART II: CLARIFYING THE SALES AND USE TAX EXEMPTION FOR MACHINERY AND EQUIPMENT USED IN MANUFACTURING, RESEARCH AND DEVELOPMENT, OR TESTING OPERATIONS

The Department is unaware of any taxpayers impacted by the amendment to the M&E exemption in Part II of this proposal; therefore, Part II is assumed to have no revenue impact.

PART III: REMOTE SELLERS

In order to estimate the potential increase in revenue generated from Part III of this proposal, the “click-through” nexus impacts were evaluated.

“Click-through nexus”

- A number of states have either considered or passed similar legislation to this proposal in the past several years. Notably, New York State passed legislation and is now collecting sales tax from remote sellers. For FY 2013, \$142 million was collected from 35 taxpayers. As New York State has population approaching 20 million residents and includes the largest, most densely populated city in the nation, New York City, additional research was conducted to look at other states with similar laws that more closely resemble Washington.

- Both Georgia (population 9.9 million) and North Carolina (9.8 million) are more comparable by population to Washington, and each has evaluated similar proposals in recent years. In 2012, Georgia estimated an impact ranging from \$0 to \$19 million for FY 2014, depending on if or how many remote sellers chose to terminate their relationships with Georgia-based affiliates. In 2009, North Carolina estimated an impact of \$ 3.8 million for FY 2010 and \$8.5 million for FY 2011. In 2010, North Carolina enacted a program to give retailers who operate an affiliate program in North Carolina an opportunity to resolve their tax liability. This resulted in registering 32 retailers generating an additional \$12 to \$14 million in sales tax revenue.

- Unlike Washington, neither New York, Georgia, nor North Carolina had previously established nexus with some of the largest internet retailers. In 2013, one of the largest internet retailers did approximately \$67.9 billion in remote sales in the US, accounting for 26% of total US remote sales.

- An estimate for the potential increase in revenue generated from the "click-through nexus" portion of this proposal was generated by:

- Using revenue estimates derived from the experience of New York, Georgia, and North Carolina's similar "click-through nexus" legislation and prorating and adjusting these values to Washington State based on population size and per capita personal income.

- Further adjusting these values to account for the fact that Washington already has nexus with one of the largest internet retailers.

- Finally, an additional 10 percent adjustment was made to account for Washington having higher than average voluntary compliance with remote sellers and an active out-of-state audit presence compared to many other states.

- After these adjustments were made, a three state average value was computed to represent Washington's potential revenue increase from the passage of the "click-through nexus" portion of this bill.

REVENUE IMPACT - Part III "Click through nexus"

State Government (cash basis, \$000):

FY 2016 -	\$ 14,458
FY 2017 -	\$ 16,533
FY 2018 -	\$ 17,302
FY 2019 -	\$ 18,002
FY 2020 -	\$ 18,731
FY 2021 -	\$ 19,489

GENERAL ASSUMPTIONS

This bill is assumed effective on July 1, 2015, resulting in 11 months of impacted collections for Fiscal Year 2016.

DATA SOURCES

- Georgia State University Fiscal Research Center, Fiscal Note for House Bill 386 Substitute (LC 34 3477S), March 19, 2012
- North Carolina General Assembly, Fiscal Research Division, remote seller fiscal estimates and revenue generation data, 2009 & 2010
- New York State Department of Taxation and Finance data
- Internet Retailer Top 500 Guide, 2013
- US Census Bureau Population Estimates, 2013
- Economic and Revenue Forecast Council, June 2014 forecast
- Department of Revenue data
- Census Bureau E-States data

TOTAL REVENUE IMPACT:

The state will realize a revenue gain of \$4.2 million in Fiscal Year 2016 and a revenue gain of \$4.5 million in Fiscal Year 2017, resulting in a revenue gain of \$8.7 million for the 2015-17 Biennium.

State Government (cash basis, \$000):

FY 2016 -	\$ 4,240
FY 2017 -	\$ 4,495
FY 2018 -	\$ 4,301
FY 2019 -	\$ 3,961
FY 2020 -	\$ 3,567

FY 2021 - \$ 3,112

Local Government, if applicable (cash basis, \$000):

FY 2016 - \$ 1,574

FY 2017 - \$ 1,668

FY 2018 - \$ 1,596

FY 2019 - \$ 1,470

FY 2020 - \$ 1,323

FY 2021 - \$ 1,155

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived. Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing functions.

ASSUMPTIONS

This proposal affects approximately 1,000 taxpayers.

INITIAL COSTS

The Department will incur costs of \$28,500 in Fiscal Year 2015 that are NOT included in the six-year expenditure impact for this fiscal estimate. These start-up costs include:

Labor Costs - Time and effort equates to 0.3 FTEs.

- Additional staff to create a special notice, update web content, create a mailing list, and respond to letter ruling requests.

Object Costs - \$1,300.

- Printing and mailing a special notice to affected taxpayers.

FIRST YEAR COSTS

The Department will incur total costs of \$315,000 in Fiscal Year 2016. These costs include:

Labor Costs - Time and effort equates to 3.7 FTEs.

- Creating one new administrative rule and amending two administrative rules,
- Additional staff to set up, program, and test computer system changes,
- Providing technical advice and rule interpretation,
- Resolving additional error and out of balance and amended returns; preparing refunds and assessments; and responding to secure messages, correspondence, and telephone questions,
- Reconciling sales data by remote sellers during the audit process.

Object Costs - \$400.

- Printing and mailing tax return information to new taxpayers.

SECOND YEAR COSTS

The Department will incur total costs of \$259,000 in Fiscal Year 2017. These costs include:

Labor Costs - Time and effort equates to 3.4 FTEs.

- Providing technical advice and rule interpretation,
- Resolving additional error and out of balance and amended returns; preparing refunds and assessments; and responding to secure messages, correspondence, and telephone questions,
- Reconciling sales data by remote sellers during the audit process,
- Identifying, contacting, educating, assessing, and collecting sales taxes due from unregistered taxpayers.

Object Costs - \$1,200.

- Printing and mailing tax return information to new taxpayers,
- Filing fees and postage to mail warrants and delinquency notices.

ONGOING COSTS

Ongoing costs for the 2017-19 Biennium equal \$507,700 and include similar activities described in the second year costs. Time and effort equates to 3.4 FTEs.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2016	FY 2017	2015-17	2017-19	2019-21
FTE Staff Years	3.7	3.4	3.6	3.4	3.3
A-Salaries and Wages	185,300	161,000	346,300	316,900	311,800
B-Employee Benefits	55,700	48,300	104,000	95,100	93,600
E-Goods and Other Services	46,700	40,000	86,700	78,300	77,200
G-Travel	3,100	3,300	6,400	6,600	6,600
J-Capital Outlays	24,300	6,400	30,700	10,800	10,600
Total \$	\$315,100	\$259,000	\$574,100	\$507,700	\$499,800

III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	Salary	FY 2016	FY 2017	2015-17	2017-19	2019-21
ADM ASST 5	47,014	0.0		0.0		
EMS BAND 4	103,896	0.0		0.0		
EMS BAND 5	121,645	0.0		0.0		
EXCISE TAX EX 3	50,563	0.1	0.1	0.1	0.1	
HEARINGS SCHEDULER	32,688	0.0		0.0		
REVENUE AGENT 2	47,014	2.4	2.6	2.5	2.6	2.6
REVENUE AUDITOR 2	48,164	0.2	0.2	0.2	0.2	0.2
TAX INFO SPEC 3	48,164	0.5	0.5	0.5	0.5	0.5
TAX POLICY SP 2	61,628	0.0		0.0		
TAX POLICY SP 3	69,756	0.4		0.2		
TAX POLICY SP 4	75,080	0.0		0.0		
Total FTE's	705,612	3.7	3.4	3.6	3.4	3.3

Part IV: Capital Budget Impact

Identify acquisition and construction costs not reflected elsewhere on the fiscal note and describe potential financing methods

NONE

None.

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

Should this legislation become law, the Department will use the expedited process to amend WAC 458-20-15503, titled: "Digital products." The Department will also use the standard process to amend WAC 458-20-13601, titled: "Manufacturers and processors for hire-Sales and use tax exemption for machinery and equipment." Should this legislation become law, the Department will use the complex process to create one new rule regarding remote sellers. Persons affected by this rule making would include sellers and purchases of digital automated services, software developers, and remote sellers.

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