



TACIR

The Tennessee Advisory Commission
on Intergovernmental Relations



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MEMORANDUM

TO: Commission Members

FROM: Cliff Lippard *Cliff*
Executive Director

DATE: 1 February 2019

SUBJECT: House Bill 971/Senate Bill 1075 (Local Revenue and Services)—Interim Report for Review, Comment, and Approval

The attached interim Commission report is submitted for your review, comment, and approval. It was prepared in response to a request by the House Finance, Ways, and Means Committee in April of 2018. During its discussion of House Bill 971 by Representative Sargent, Senate Bill 1075 by Senator Watson, the committee asked the TACIR to study the revenue sources of cities and counties in Tennessee and the services cities and counties provide. The Commission formed a working group of its local members to examine these issues, and the group suggested the study focus initially on internet sales tax collection and distribution in light of the *South Dakota v. Wayfair* case and on provisions of Tennessee law, set to become effective July 1, 2019, relating to the Streamlined Sales and Use Tax Agreement (SSUTA)—a multistate effort that has the effect of reducing the burden of sales and use tax collection on retailers.

The Supreme Court's *Wayfair* decision in June 2018 opened the way for states to require more out-of-state sellers with no physical presence in the state to collect sales tax. Tennessee already has a rule—Tennessee Department of Revenue Rule 129—that would require out-of-state sellers with more than \$500,000 in sales in Tennessee to collect and remit sales tax, but the General Assembly put enforcement of the rule on hold until further review. **Because it would eliminate an unfair tax advantage for some out-of-state sellers, wouldn't apply retroactively, and includes a safe harbor for those who transact only limited business in the state, the General Assembly should allow the Department of Revenue to enforce Rule 129.**

In its *Wayfair* decision, the Supreme Court spoke favorably of South Dakota's full membership in SSUTA, but it did not require full membership in SSUTA as a prerequisite for taxing out-of-state sellers without a physical presence in a state. Previously, Tennessee adopted some SSUTA simplification provisions to become an associate member of SSUTA, along with some others with implementation delayed until July 1, 2019, that were necessary for full membership. But some of those provisions would involve significant changes to Tennessee's sales and use tax laws that may not be in the state's interest at this time. They include three major changes to the state's sales and use tax laws:

- For sales between sellers and consumers who are both located in Tennessee, the jurisdiction in which delivery occurs, not necessarily the jurisdiction in which the seller is located, would receive the local option sales tax revenue. **To avoid complicating sales tax collection for in-state sellers and to avoid shifting revenue away from jurisdictions where infrastructure investments have already been made to support retail locations, Tennessee should continue to distribute local option sales tax revenue from intrastate sales to the jurisdiction where the sale originated, not to its delivery destination.**
- The state and local single article caps would be limited to motor vehicles, aircraft, watercraft, modular homes, manufactured homes, and mobile homes. Although not required by SSUTA, a program is set to go into effect on July 1, 2019, to refund businesses for additional tax owed because of this change. **To avoid the need for such a program, and to avoid raising taxes on the sale of non-exempt high value items, Tennessee should retain its single article sales tax cap for all sales.**
- The uniform 2.25% local option sales and use tax rate option for out-of-state sellers with no physical presence in Tennessee would be eliminated. Local option sales tax revenue from sellers that choose to apply the uniform 2.25% rate option is distributed in the same proportion as collections of other local option sales tax revenue, but representatives of cities and counties agree that this distribution is inequitable. **To ensure a more acceptable distribution of local option sales tax revenue from out-of-state sellers with no physical presence in the state, the state could continue to offer sellers the option of paying the destination rate or the uniform rate, but in either case, distribution of the revenue should be based on the destination of the sales. Alternately, another distribution formula basis, such as population, could be used.**

Several other provisions originally adopted for SSUTA membership are also scheduled to become effective July 1, 2019, without further action by the General Assembly. These

provisions would affect the state and local tax base, local rate and boundary changes, state and local tax rates, general sourcing, general sourcing definitions, direct mail sourcing, telecommunications sourcing, exemption administration, uniform tax returns, caps and thresholds, and bundled transactions. **Because of the streamlining provisions that are already in effect, it is unlikely that any of these provisions would be necessary for the state to withstand a constitutional challenge, if it allows Rule 129 to go into effect, based on the Court's decision in *Wayfair*. And unlike the provisions discussed above that affect sourcing for in-state deliveries, limit the single article cap, and eliminate the uniform rate option for out-of-state sellers, the Commission takes no position on whether these other provisions should become effective.**