

THE STREAMLINED SALES AND USE TAX AGREEMENT AND SOUTH CAROLINA

**A REVIEW OF THE REQUIREMENTS TO COMPLY
AND THE AGREEMENT'S POSSIBLE IMPACT ON
SOUTH CAROLINA IF THE GENERAL ASSEMBLY
AMENDS THE STATE AND LOCAL SALES AND
USE TAX LAWS TO COMPLY**

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Prepared by: Rick Handel
John P. McCormack
Office of General Counsel for Policy
SC Department of Revenue

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I. Executive Summary¹

The determination as to whether or not South Carolina should participate in the nationwide sales tax streamlining effort is an important State fiscal policy issue. The goal of this report is to inform the Department's policy makers of the key elements of the Streamlined Sales and Use Tax Agreement.

The Streamlined Sales Tax Project was founded in March 2000. Its purpose was to simplify and unify state and local sales taxes. While such an effort would be beneficial for both the governments that impose the taxes and the businesses required to collect them, sales tax streamlining is also an effort by states to enhance sales and use tax collections on mail order, catalog, Internet and other remote sales. Increasing collections from remote sellers would allow the State to provide additional services and/or tax relief to its taxpayers, and decrease the competitive disadvantage of Main Street stores that must collect the tax.² The expectation of the states is that many out-of-state businesses without a requirement to collect sales and use taxes will voluntarily collect tax when the states adequately streamline and simplify their sales taxes. There is also the possibility that Congress will require out-of-state businesses to collect sales and use taxes for states that adopt the Streamlined Sales and Use Tax Agreement.

Background

The simplification measures crafted by the Streamlined Sales Tax Project are contained in a multi-state compact called the "Streamlined Sales and Use Tax Agreement" (Agreement"). The provisions in the Agreement address nearly every aspect of sales taxation. Some of the requirements relate to how a member state may structure its tax. These include: single state and local tax base; uniform definitions; tax rate simplifications; uniform sourcing rules; simplified exemption administration; elimination of "caps" and "thresholds;" and, simplified sales tax holidays.

Other requirements in the Agreement are related to sales tax administration. These include: centralized registration; new tax collection technology models; monetary compensation for certain retailers; uniform rules for tax rounding; uniform tax returns; uniform rules for the use of direct pay permits; uniform rules for recovery of bad debt; customer refund procedures; and, tax amnesty.

States must enact legislation to comply with the Agreement. To date, 15 states have been accepted as full members and seven as associate members.³

¹ In order to avoid the extensive use of footnotes, it should be noted that most of the information that is not South Carolina specific comes from three excellent sources, *Streamlining New York's Sales Tax: Examining Requirements for Compliance with the Streamlined Sales and Use Tax Agreement*, Office of Tax Policy Analysis, New York State Department of Taxation and Finance (October 2006); *Streamlined Sales and Use Tax 2006/2007*, Walter Hellerstein and John A. Swain (Warren, Gorham & Lamont of RIA 2007); and the Streamlined Sales Tax Governing Board, Inc.'s web site, www.streamlinedsalestax.org.

² See Exhibit E-2, "Do Internet Tax Policies Place Local Retailers at a Competitive Disadvantage?"

³ The number of full member states will increase in the near future. Associate member state Washington will become a full member effective January 1, 2008. Associate member states Arkansas and Wyoming have filed

Streamlining South Carolina's State and Local Sales Tax

South Carolina adopted legislation in 2002 (Act No. 334 of 2002, Section 6) that allowed the state to participate in the Streamlined Sales Tax Project. Since then, South Carolina has participated; however, for the most part the focus has been to monitor the progress of the streamlining effort.

South Carolina's state and local sales tax does not comply with a large number of the Agreement's provisions. The sales and use tax laws, both state and local, would need to be amended to comply with the Agreement and join the Governing Board that administers the Agreement. For example, sales tax exemptions would need to incorporate the Agreement's uniform product definitions. This may change the taxability of certain food, telecommunication services, and medicines. Maximum tax provisions for certain items and additional tax rates would no longer be permitted.

Some changes that would be required would affect local jurisdictions that impose sales and use taxes. For example, all local jurisdictions would be required to impose sales and use taxes on an identical base.

Another class of conforming changes would require that South Carolina incorporate new administrative features into the sales tax. These provisions include offering a sales and use tax amnesty, allowing businesses to use a state-certified software system to perform their sales tax collection responsibilities, and permitting sellers to collect tax on based on the ZIP code of the purchaser.

Examples of some of the changes that would be required to comply with the Agreement include, but are not limited to:

ISSUE	EXAMPLES OF THE REQUIRED CHANGES
Uniform Tax Base	<p>In order to comply with the requirement for a uniform state and local tax base, the following changes must be made:</p> <ul style="list-style-type: none">• An amendment to various statutes (state and local) so that the state tax and all local taxes either (1) exempt unprepared food in accordance with the definitions and provisions of the Agreement, (2) tax unprepared food in accordance with the definitions and provisions of the Agreement, or (3) exempt such unprepared food from the state tax, but tax such unprepared food under all local sales and use taxes.⁴ Presently, some local

petitions for full member state status effective January 1, 2008. However, Utah and Ohio may lose associate member status January 1, 2008 and Tennessee has enacted conforming legislation effective July 1, 2009.

⁴ Section 308 of the Agreement provides a limited exception to uniformity that would allow a member state to exempt "food" or "drugs," as defined by the Agreement, from the state tax by applying a 0% state tax rate, but to tax such "food" or "drugs" at the local level. However, all local jurisdictions must tax these items under this alternative. Some local jurisdictions may not exempt these items while others tax them as is presently the case in South Carolina with respect to "food."

	<p>taxes exempt food eligible to be purchased with USDA food stamps.⁵</p> <ul style="list-style-type: none"> • An amendment to various statutes (state and local) so that the state tax and all local taxes either exempt certain casual excise tax items or tax these casual excise tax items. <p>The casual excise tax is a tax, separate from the sales and use tax, imposed on the issuance of a certificate of title or other proof of ownership for motor vehicles, motorcycles, boats, motors, and airplanes when they are sold by non-retailers. If a retailer sells these items, then the sales tax or use tax would apply and not the casual excise tax.</p> <p>Presently, all local taxes exempt maximum tax items, while some local taxes also exempt casual excise tax items. The local taxes that do not exempt casual tax items are therefore imposing the tax on trailers that can be pulled by a vehicle other than a truck tractor, pole trailers, and boat motor not attached to the boat at the time of the sale. These items are exempt from the local taxes which specifically exempt both maximum tax items and casual tax items.</p> <p>In order to comply with the Agreement, this discrepancy must be resolved so that trailers that can be pulled by a vehicle other than a truck tractor, pole trailers, and boat motor not attached to the boat at the time of the sale are either exempt from both state and all local sales and use taxes or subject to tax under state and all local sales and use taxes.</p> <ul style="list-style-type: none"> • An amendment to various statutes (state and local) so that the state tax and all local taxes either exempt certain maximum tax items⁶ or tax certain maximum tax items. Maximum tax items are those items for which the General Assembly has established a maximum sales tax or use tax due with respect to the sale or purchase of certain items. In most cases, the maximum tax due is \$300.00 <p>The items subject to the maximum tax, as listed in Code Section 12-36-2110, are aircraft (including unassembled aircraft kits), motor vehicles, motorcycles, boats, trailers and semitrailers that can only be pulled by truck tractors, horse trailers, recreational</p>
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⁵ If South Carolina participates in the Agreement, it must use the definitions and provisions established in the Agreement; therefore, the South Carolina could no longer use of the USDA food stamp program in determining the taxation of unprepared food for sales tax purposes. See also Section A.2. of this report concerning “Definitions.”

⁶ See also discussion on “Caps and Thresholds” in Section B - “Tax Rates.”

	<p>vehicles (tent campers, travel trailers, park models, park trailers, motor homes, and fifth wheels), self-propelled light construction equipment limited to a maximum 160 net engine horsepower, manufactured homes, certain musical instruments and office equipment purchased by religious organization, and fire safety education trailers.</p> <p>Since the Agreement does not apply to motor vehicles, watercraft, aircraft, and modular and manufactured homes, the maximum tax items in question are trailers and semitrailers pulled by a truck tractor, horse trailers, non-motorized recreational vehicles, and musical instruments and office equipment purchased by a religious organization. Therefore, in order to comply with the tax base uniformity provisions of the Agreement, South Carolina must either exempt these items from the state tax and all local taxes or tax these items under state tax and local taxes.</p>
Definitions	<p>A state, in order to comply with the definitions set forth in the agreement, may need to:</p> <ul style="list-style-type: none"> • Eliminate an exemption or exclusion⁷ and tax the sale of the item and increase revenue; or • Comply with the Agreement’s definition and either increase revenue or lose revenue; or <ul style="list-style-type: none"> ▪ If complying with the Agreement’s definition will cause a loss in revenue, the state may be able to create a new “replacement” tax outside of its sales and use tax so that the change is revenue neutral. However, the Governing Board is considering restrictions on a state’s ability to create replacement taxes. See the discussion of “Replacement Taxes” in Section XII – Current Issues. <p>Since product definitions affect exemptions, see the next section on “Exemptions” for similar changes that may be necessary in order to comply with the Agreement.</p>

⁷ An exemption concerns a sale at retail, and as a retail sale, the transaction would be taxable except for the exemption provided by the General Assembly.

An exclusion is typically a transaction that the General Assembly has removed from taxation so as to not include it as a “retail sale” or a part of a “retail sale.” Therefore, since it is not a retail sale, or part of one, it is not taxable since the sales and use tax only applies to retail sales.

Exemptions	<p>The requirement to use the Agreement’s product definition will most likely affect revenue. As such, the General Assembly will need to decide for each affected exemption one of the following options:</p> <ul style="list-style-type: none"> ▪ Continue to exempt the product using the required definition and accept the gain or loss in revenue as applicable; ▪ Continue to exempt the product using the required definition, but, to the extent possible, reword the exemption in a manner that will offset increases in revenue as a result of the definition or that will offset revenue loss as a result of the definition, whichever is applicable; • Adopt some or all of the optional restrictions, if any, allowed in a definition so as to reduce any possible revenue loss; or, • Eliminate the exemption to reduce any possible revenue loss. <p>Note: In Act No. 388 of 2006, Part V, Section 1, the General Assembly enacted legislation requiring it to review the sales tax exemptions in Code Section 12-36-2120 no later than its 2010 session. After the initial review, the General Assembly must review these exemptions as it deems appropriate but not later than its session every 10 years after the first review. In addition, a seven member Joint Sales Tax Exemptions Review Committee has been authorized to assist the General Assembly in reviewing the sales tax exemptions. The committee must make a detailed and careful study of the exemptions, comparing South Carolina laws to other states; publish a comparison of the exemptions to other states’ laws; recommend changes, recommend the introduction of legislation when appropriate; and submit reports and recommendations annually to the Governor and the General Assembly regarding the exemptions.</p>
Single Tax Rate	<p>The following changes must be made in order to establish a single state tax rate (with exceptions noted above) in South Carolina:</p> <ul style="list-style-type: none"> ▪ An amendment to the state law to do one of the following: (1) lower the 7% state tax rate for the sales tax on accommodation to 6%, (2) raise the 6% state tax rate on all other items and services to 7%, or (3) repeal the 7% sales tax on accommodations and create a new separate 7% “lodging” tax.

	<p>A separate “lodging” tax would likely require hotels and others providing sleeping accommodations to file several returns – a sales tax return, a lodging tax return, and possibly a local accommodations tax return. (Note: A separate lodging tax appears to be the norm among the states since taxes on accommodations are typically imposed at a higher rate than the general sales and use tax rate.) See the discussion of “Replacement Taxes” in Section XII – Current Issues.</p> <ul style="list-style-type: none"> • An amendment to the state law to do one of the following: (1) lower the 11% rate on 900 and 976 telephone numbers to 6%, (2) repeal the 11% tax on 900 and 976 telephone numbers, or (3) repeal the 11% tax on 900 and 976 telephone numbers and create a new separate 11% “900 and 976 service” tax. A separate “900 and 976 service” tax would require some communications companies providing 900 and 976 telephone services as well as other communications services (“ways or means for the transmission of the voice or messages”) to file these returns – a sales tax return for communication services and a “900 and 976 service” return. • An amendment to the state law so that sales of trailers and semitrailers to nonresidents would no longer be taxed at the rate charged in the purchaser’s state of residence. Such sales must be taxed at the South Carolina rate. (The exception in the Agreement for motor vehicles would not require this change for motor vehicles.) • An amendment to state law so that sales to persons eighty-five years of age and older are taxed at the full tax rate or are completely exempt. Presently, sales to persons eighty-five years and older are taxed a rate 1% less than the full tax rate.
Caps and Thresholds	<p>In order to comply with the Agreement’s provisions concerning caps and threshold, the General Assembly would need to make the following changes to the law:</p> <ul style="list-style-type: none"> ▪ An amendment of the \$300 maximum tax provisions to either eliminate the maximum tax for, or to completely exempt from the tax, the following items: <ul style="list-style-type: none"> (1) unassembled aircraft, (2) trailers and semitrailers pulled by a truck tractor, (3) horse trailers, (4) non-motorized recreational vehicles, such as tent campers, travel trailers, park models, park trailers, and fifth wheels, and

	<p>(5) musical instruments and office equipment sold to religious organizations.</p> <p>The General Assembly may be able to exempt these and other maximum tax items by exempting them from the sales and use tax and imposing a new replacement tax on such items. See the discussion of “Replacement Taxes” in Section XII – Current Issues.</p> <ul style="list-style-type: none"> ▪ An amendment to the fifty percent exemption for sale of a modular home and the seventy percent exemption for the rental or lease of portable toilets to fully tax such transactions or to fully exempt such transactions. Or, with respect to modular homes, the General Assembly could tax the purchase, or the cost of, the material incorporated into the modular home. ▪ An amendment to fully tax or to fully exempt immediately “construction materials used in the construction of a single manufacturing and distribution facility with a capital investment of at least one hundred million in real and personal property in the State over an eighteen-month period” – if the exemption is not fully implemented when (and if) the Agreement is adopted in South Carolina. • An amendment to fully tax or to fully exempt immediately “durable medical equipment” if the exemption is not fully implemented when (and if) the Agreement is adopted in South Carolina
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As can be seen from the above examples, it is up to each state to determine how it will to achieve compliance with the Agreement. Complying with the Agreement’s requirements will require policy choices regarding how South Carolina should conform to the Agreement.

These choices could be based on a specific tax policy objective. For example, decisions that strictly align the State and local sales taxes with the Agreement’s provisions limiting the number of tax rates, eliminating local options, and repealing thresholds would advance the goal of simplification of the South Carolina sales tax base. Conversely, decisions intended to work around the Agreement’s limitations on the structure of the state’s tax base and rates by enacting “replacement taxes” to maintain revenue would make tax compliance for local businesses more complex.

Once conformed to the Agreement, a member state must annually re-certify to the Governing Board that it has maintained compliance with the Agreement’s provisions. To maintain compliance, South Carolina would need to ensure that any sales tax legislation

enacted while it is a member does not violate the terms of the Agreement. South Carolina would also be required to make statutory changes to maintain compliance with respect to new provisions added to the Agreement and new interpretations of the Agreement by the Governing Board. If South Carolina were to fail to maintain compliance with the Agreement it could be expelled from the Agreement.

Any changes to comply, or maintain compliance, would not only affect large multi-state retailers, but would affect all types of local businesses, including ones not involved in making sales through catalogs, web sites, or other remote means.

Revenue Implications for South Carolina

One of the major purposes of the Agreement is to ensure the state receives the proper tax revenue from sales involving out-of-state retailers such as Internet and mail order retailers and to promote a level playing field for South Carolina brick and mortar sellers who must compete with Internet and mail order retailers.⁸ Having out-of-state retailers collecting and remitting the tax voluntarily by participating in the Agreement, or being required to participate pursuant to federal legislation (if enacted), will increase sales and use tax revenues.

The issue is how much of an impact would participating in the Agreement have on sales and use tax revenues.

In addressing this issue of the revenue impact of participating in the Agreement, there are several important points to consider:

- Unless federal legislation is enacted, the participation in the Agreement of retailers that do not have nexus with South Carolina is voluntary.

The fact that a state is a member state in the Agreement does not require a retailer to participate under the Agreement. The system created by the Agreement is voluntary. On the other hand, if a seller registers in one state, the seller must register in all states participating in the Agreement. However, as is the case now, if a seller has nexus with a state, the seller must collect and remit the tax to that state. As such, revenue will not be certain since there is no way to determine how many retailers and which retailers will participate.

- Retailers who voluntarily participate in the Agreement are eligible for amnesty.

If South Carolina were to adopt and come into compliance with the Agreement, amnesty would be available for 12 months for all sellers not presently registered for collecting and remitting the sales and use tax in South Carolina (provided the seller has not been notified of an audit and does not have an ongoing, unresolved audit). As such, prior liabilities of any seller who had nexus but was not registered with South Carolina will be lost. The seller is required to be registered and

⁸ See Exhibit E-2, "Do Internet Tax Policies Place Local Retailers at a Competitive Disadvantage?"

collecting and remitting the tax for 36 months in order for the amnesty to be fully effective.

- Retailers who have nexus with South Carolina at this time are already required to collect and remit the tax regardless of South Carolina's participation in the Agreement.

These retailers, if they are not registered with the Department, are liable for sales and use taxes with respect to past sales into South Carolina for the time period in which they had nexus. The Department has, and continues to, bring into compliance out-of-state taxpayers who are doing business in South Carolina and who have the requisite nexus with South Carolina. See next bullet concerning the Department's "Nexus/Discovery Team."

- The Department has had, and continues to have, significant success in registering Internet companies and other out-of-state taxpayers for collecting and remittance of the tax.

The Department's "Nexus/Discovery Team" was established to bring into compliance out-of-state taxpayers who are doing business in South Carolina and who have the requisite nexus with South Carolina.

Information concerning these non-filers is obtained through various methods, including but not limited to, Department database crosschecks, regional and national exchange programs, Internet research, and referrals by Department auditors.

The Nexus/Discovery Team also manages the Department's "Voluntary Disclosure Program" that allows taxpayers who have sufficient South Carolina "nexus," and have not registered with the Department, to collect or remit South Carolina taxes. This voluntary disclosure program is designed to (1) encourage nonfilers to come forward voluntarily and begin paying taxes without incurring penalties and (2) allow the Department to maximize compliance with limited resources.

As a result of these programs, 20 of the top 25 e-retailers are registered with the Department and collecting and remitting sales and use taxes.

For fiscal years ending June 30, 2002 through June 30, 2006, this team averaged 202 new registrants per year (all taxes, but primarily income and sales and use taxes) and \$7,300,000.00⁹ in collections each year from these new registrants.

⁹ Collection revenue as shown in this average includes all back taxes collected from new registrants plus revenue generated in the first year by previous registrants.

For the most recent fiscal year ending on June 30, 2007, the Nexus/Discovery Team registered 315 new taxpayers and collected \$14,526,596.00.¹⁰

- The change in how traditional brick and mortar retailers operate their Internet sales operations.

At one time, many “brick and mortar” retailers established “barriers” between their retail store operations and their Internet sales operations. This reduced the chances of nexus being established with the Internet operation. However, over the last several years, many of these businesses have eliminated these barriers (e.g., customers can return Internet purchases to a related “brick and mortar” store). Therefore, nexus is established with the Internet operation and more of these operations are registering and remitting taxes. As such, loss of revenue to Internet sales may not be as high as previously estimated.

This position is supported by a 2004 report by Forrester Research Inc. for the National Governor’s Association and the National Conference of State Legislatures (Attached as Exhibit E-1). The report, entitled *The Growth of Multichannel Retailing*, states that this method of business, whereby a “brick and mortar” taxpayer located in a state also sells via an Internet website, establishes the requirement for the collection and remittance of sales and use taxes for such sales made via the Internet. It also reports that multichannel retailing accounts for 75% of Internet sales.

The report states with respect to the collection of sales tax:

A site-by-site review of the top 100 retail sites reveals that the majority of retailers now also collect sales tax: Of those that sell online, 94% of the top retailers collect sales tax online in states in which they have nexus.

Finally, in the July 2004 update of one of the most widely quoted reports concerning the revenue loss from e-commerce,¹¹ the loss estimates were lowered with one explanation being the growth of multichannel retailing.¹²

- The uncertainty of revenue loss estimates by published studies on revenue lost by states because of Internet sales.

See *State and Local Sales Tax Revenue Losses from E-Commerce: Estimates as of July 2004* by Dr. Donald Bruce and Dr. William F. Fox of the Center for Business

¹⁰ Collection revenue as shown includes all back taxes collected from new registrants plus revenue generated in the first year by previous registrants.

¹¹ *State and Local Sales Tax Revenue Losses from E-Commerce: Estimates as of July 2004* by Dr. Donald Bruce and Dr. William F. Fox of the Center for Business and Economic Research at the University of Tennessee.

¹² The report, in a footnote, cites the example of firms merging their online and offline channels after initially seeking to separate the activities and references the report - *The Growth of Multichannel Retailing*.

and Economic Research at the University of Tennessee (“*Bruce and Fox Report*”) and *A Current Calculation of Uncollected Sales Tax Arising from Internet Growth* by Peter A. Johnson, Senior Economist for The Direct Marketing Association (“*DMA Report*”).

The following is information from the “*Bruce and Fox Report*” as to the authors’ estimated revenue losses from e-commerce as it relates to South Carolina:

Estimated State and Local Revenue Loss for 2003

\$179.4 million (low growth scenario)
\$186.9 million (high growth scenario)

Estimated State and Local Revenue Loss for 2008

\$252.3 million (low growth scenario)
\$394.5 million (high growth scenario)

Estimated State-Local Split of Revenue Loss for 2008

\$243.0 million state; \$9.3 million local (low growth scenario)
\$380.0 million state; \$14.5 million local (high growth scenario)

Estimated State Revenue Loss for 2008 as a Percentage of 2003 State Total Tax Collections

3.8% (low growth scenario)
6.0% (high growth scenario)

The “*DMA Report*,” while it does not give a state by state breakdown of estimated revenue losses due to e-commerce, concludes the following:

Nationwide Estimate for Uncollected Sales Tax from the Internet

\$1.9 billion for 2001
\$4.5 billion for 2011

The author of the “*DMA Report*” notes in his executive summary that the \$4.5 billion revenue loss for 2011 is less than 10% of the amount projected by the 2001 “*Bruce and Fox Report*.”¹³

Finally, using the “*Bruce and Fox Report*” to determine South Carolina’s percentage of the nationwide revenue loss (based on the 2008 estimated numbers) and applying that South Carolina percentage to the nationwide estimate for uncollected sales tax from the Internet from the “*DMA Report*,” the South Carolina’s estimate for uncollected sales tax for 2011 from the Internet using the “*DMA Report*” as the basis for revenue loss would be \$52.65 million calculated as follows:

South Carolina: \$394.5 million (high growth scenario) for 2008

¹³ The “*Bruce and Fox Report*” cited in this document and provided as an exhibit is the report from 2004.

Nationwide: \$33,667.8 million (high growth scenario) for 2008
SC Percentage of Nationwide Loss: 1.17% (\$394.5/\$33,667.8)
SC Estimated Loss for 2011 Based on the DMA Report: \$52.65 million
(\$4.5 billion x 1.17% = \$52.65 million)

See Exhibits “F” and “G.”

- The uncertainty of the revenue in conforming to the Agreement.

Hundreds of decisions, both large and small, will have to be made by the General Assembly if it decides to conform the sales and use tax laws to the Agreement. As mentioned previously in this document, decisions will have to be made as to certain impositions, tax rates (raise, lower, or the creation of replacement taxes), exemptions (eliminate, expand or modify in some manner), and administrative provisions. The General Assembly may also have to balance changes that increase revenue against those that decrease revenue – an approach that may create “winners” and “losers” among taxpayers. While these changes can be designed in such a way to minimize the impact on revenue, the significant number of changes necessary will significantly increase the uncertainty of the ultimate revenue estimate.

- The costs associated with conforming to the Agreement.

There will be new costs to the state if it conforms to the sales and use tax law to the Agreement. The Agreement requires the adoption of new technologies (e.g., participating in the central registration system, accepting the simplified electronic return, developing the rate and address databases), extensive systems programming and processing changes by the Department, compensation member states provide Certified Service Providers (this compensation ranges from 2 to 8 percent of tax collected from sellers that do not have nexus with the state), and the annual membership fees for membership in the Governing Board.¹⁴

- While one of the goals of the Agreement is simplification, the changes will not be simple for local businesses.

While the Agreement simplifies collecting and reporting of the tax by establishing the same rules for many states, the rules themselves are not simple. The many product definitions and the possibilities of replacement taxes to replace lost revenue create complexity that may affect compliance and therefore revenue. There will be a significant “learning curve” for local retailers.

¹⁴ See Section IV, F.1 – “Collection and Service Providers.”

Governance

If South Carolina were to enact legislation to comply with the Agreement and the Governing Board were to accept our petition for membership, then South Carolina would be required to abide by the Agreement and all legal interpretations involving the Agreement (e.g., definition of food, certain tax terms, sourcing rules, etc.) and could only enact sales tax legislation and regulations that are in compliance with the Agreement and Governing Board interpretations. Compliance must be maintained and is reviewed each year and any state that is not in compliance is subject to expulsion from the Board and would therefore no longer be a participant in the Agreement.

The Agreement is not a static document. Since adopted in November 2002, the Agreement has been amended 9 times (4 times in 2006 alone). Additional amendments are likely. Seventeen proposed amendments to the Agreement will be considered at the September 19-20, 2007, Governing Board meeting. Changes in the Agreement could force South Carolina to either adopt provisions that the General Assembly does not consider to be in the best interest of South Carolina or to remove itself from the Agreement.

Guidance as to the interpretation of the Agreement rests with the Governing Board and not with the Department. Taxpayers may have to wait longer to receive guidance from the Governing Board.

With respect to the governing provisions of the Agreement, South Carolina will need to consider the following:

- The interpretations by the Governing Board would, as a practical matter, serve as regulations and that would not comply with the regulation approval process presently established by the General Assembly.
- How to deal with the Administrative Law Court and the appellate courts in South Carolina issuing a finding that is contradicted by an interpretation of the Governing Board at a later date or the Administrative Law Court and the appellate courts in South Carolina issuing a finding that contradicts a previously issued interpretation of the Governing Board.
- A provision in proposed federal legislation allows persons who petition the Governing Board on an issue regarding the Agreement to appeal the decision of the Governing Board to the United States Court of Federal Claims or bring an action in the Court if the Governing Board fails to act on the petition. The Court may remand the matter to the Governing Board for action consistent with the Court's decision.

Conclusion

Simplification is one of the major purposes of the Agreement. There are aspects of the Agreement that provide simplification – for example the provisions concerning identical state and local tax bases and a single state tax rate. Such changes, of course, would be helpful whether or not they are done as part of any agreement. However, there are aspects of the Agreement that are complex. Most of these complex provisions concern definitions and the interpretation of such definitions. Of course, the current South Carolina sales and use tax law contains some complexities, but the taxpayers of our state are experienced in dealing with these provisions. In addition, some states have complicated the process for in-state taxpayers and other taxpayers with nexus by creating replacement taxes – a choice that South Carolina may also have to make if it decides to participate.

Also, if South Carolina decides to adopt the Agreement, transforming the state and local sales and use tax laws of South Carolina will not be a simple task – whether that task is in the technical drafting of the law, the policy and political decisions that will have to be made, the possible creation of new “replacement” taxes, the education of Department of Revenue employees and taxpayers and their employees, or the technical changes and associated costs to computer systems and software.

The changes in the industry toward multichannel retailing, the efforts of the Department’s Nexus/Discovery Team and auditors, and the Department’s participation in regional and national information exchange agreements have all assisted in registering more and more out-of-state retailers. While large Internet-only retailers cannot be compelled to register in South Carolina due to a lack of nexus, participation in the Agreement may not change that since it is voluntary. Only Congressional action can require such retailers to register in states with which they do not have nexus.

The General Assembly would also lose a significant amount of legislative autonomy and flexibility as a trade-off for enacting the law changes that would be required under the Agreement.

Finally, most states participated in the Streamlined Sales Tax Project, but only 15¹⁵ have adopted the provisions required to become full members under the Agreement and some states that were moving toward full membership (e.g., Ohio and Utah) are reconsidering their commitment to amend their laws to adopt all of the required provisions of the Agreement.

Ultimately, the General Assembly must weigh the potential for increased revenue that may be used to provide services or additional tax relief against the complexities of the Agreement and the effective loss of sovereignty to the Governing Board. Regardless, simplification of the South Carolina sales and use tax is a worthy goal and may be an

¹⁵ The number of full member states will increase in the near future. Associate member state Washington will become a full member effective January 1, 2008. Associate member states Arkansas and Wyoming have filed petitions for full member state status effective January 1, 2008. However, Utah and Ohio may lose associate member status January 1, 2008 and Tennessee has enacted conforming legislation effective July 1, 2009.

effort that the General Assembly may want to consider even if South Carolina does not adopt the Agreement.

If the decision is made not to join at this time, but to consider joining at some time in the future (perhaps if the federal legislation is enacted that allows member states to collect sales and use taxes from retailers without physical presence), then the General Assembly may wish to consider:

- Reviewing the Agreement to determine if any of its provisions should be adopted to improve South Carolina's sales and use tax law without any consideration of joining the Agreement.¹⁶
- Requiring sponsors of future amendments to South Carolina's sales and use tax law to inform the House Ways and Means Committee and the Senate Finance Committee how the proposed legislation would bring South Carolina law closer to, or farther from, the Agreement's model. This information would not be to prevent the adoption of legislation that moves South Carolina farther from the Agreement's model; it would be merely intended to inform the members of the General Assembly of the consequences of the legislation if the General Assembly were to decide, at sometime in the future, to join the Agreement.

¹⁶ For example, South Carolina presently taxes software (prewritten and custom) when delivered in tangible form and does not tax software (prewritten and custom) when delivered electronically. See SC Revenue Ruling #05-13. The Agreement includes prewritten software within the definition of "tangible personal property;" therefore, prewritten software, whether delivered in tangible form or electronically, would be subject to the tax unless the General Assembly exempts it (the Agreement allows the exemption of all prewritten software or a limited exemption for prewritten software that is delivered electronically). Custom software would not be taxed under the Agreement unless the General Assembly imposed the tax on the service of creating and selling custom software. In this example, the Agreement treats prewritten software as a product and custom software as a service and taxes prewritten software regardless of how it is transferred (tangible form or electronically). The General Assembly may decide (1) that the Agreement's perspective is the proper policy perspective for South Carolina, (2) that both prewritten and custom software are products and should be taxed regardless of how they are transferred, or (3) that it isn't prudent to change settled expectations (current policy) and that both prewritten and custom software are products and should be taxed, but only if transferred in tangible form.

II. Introduction

The purpose of this paper is to provide the basic background on the Streamlined Sales and Use Tax Agreement (Agreement) for the Department's policy makers. We hope that this information, together with their experience and knowledge of South Carolina policy and sales and use taxes, will assist them in advising South Carolina's policy makers.

To provide this background, we will:

- Summarize the background and purposes of the Agreement and South Carolina's involvement in it;
- Compare the key provisions of the Agreement with South Carolina law;
 - Where the Agreement is clear, discuss the changes South Carolina would have to make to join the Agreement,
 - Where the Agreement is not so clear, discuss the changes South Carolina may have to make to join the Agreement;
- Summarize possible federal legislation and its affect on the Agreement;
- Discuss the implications of joining the Agreement, including
 - The effect on South Carolina law of bringing South Carolina into compliance with the terms of the Agreement
 - The effect on future South Carolina law of keeping South Carolina in compliance considering:
 - Possible changes to the Agreement;
 - South Carolina Court and Department of Revenue interpretations of the Agreement;
 - Interpretations of the Agreement by its Governing Board or a federal court;
- The impact of joining the Agreement on South Carolina businesses; and
- The possible affects on State revenue of joining the Agreement.

III. Background, Purpose and Goals

State and Local Sales Taxes

The sales and use taxes are important sources of revenue for state and local governments in the United States. Forty-five states and the District of Columbia impose sales and use taxes.¹⁷ The first modern sales tax was enacted in Mississippi in 1932. South Carolina enacted its sales and use taxes in 1951.

Thousands of local governments in 36 states (over 1,000 in Texas alone) impose sales taxes, most of which are integrated with the state sales tax and are administered by the state. South Carolina first authorized local government sales taxes in 1990. Local governments are increasingly relying on sales taxes to supplement revenue from property taxes.

States generally impose retail sales taxes on sales of tangible personal property unless exempted, but only on specified services. The most typically taxed services include utilities, accommodations, amusement, repairs, cleaning services, data processing, and information services. Hawaii, New Mexico, and South Dakota have general sales tax systems that tax the broadest range of services.

Unlike state income taxes (that generally conform to the federal income tax), sales taxes developed separately. Although states often used other states' sales taxes as a starting point,¹⁸ sales taxes have substantial differences in the tax base, and rates across states, and sometimes within states, and very different administrative rules and procedures. The disparate state and local sales tax systems produce a compliance burden for multi-state businesses obligated to collect or pay the tax. Even businesses that do not primarily make retail sales may be impacted by sales tax complexities. For example, firms engaged in manufacturing or wholesaling must follow various state and local administrative rules regarding the issuance of exemption certificates.

State sales tax rates range from 2.9 percent to 7 percent, with an average of just over 5 percent. Nationwide local rates range from 0.1 percent to 5.5 percent and result in a combined average state and local rate of nearly 7.5 percent.¹⁹

In addition to variations in tax rates and in the use of local sales taxes, sales taxes differ in their legal incidence. In South Carolina and some other states the sales tax is a "privilege tax" on the retailer. The retailer is allowed, but not required, to pass the tax through to its

¹⁷ Alaska, Delaware, Montana, New Hampshire, and Oregon have no general sales tax.

¹⁸ South Carolina's original sales and use tax law is said to have been most influenced by the laws of Alabama and Tennessee.

¹⁹New York State Department of Taxation and Finance, *New York State Tax Sourcebook* (April 2005). Note: local rates in Alaska not included in this comparison. Alaska has no state sales tax, but its local rates are as high as 8 percent.

customer. If the state does not have jurisdiction to collect the tax from the retailer (doesn't have nexus with the retailer), a corresponding (or compensating) use tax is imposed on the consumer. Other states have a "consumer tax" where the legal incidence is on the purchaser,²⁰ but the retailer is required to collect the tax from its customer and pay it over to the state.

Rules for sourcing taxable transactions to state and local governments are not all the same. Most, if not all, states (including South Carolina) source transactions (*i.e.*, they are taxed) at the place the tangible personal property is delivered. Many local governments (including those in South Carolina) do the same, but many other local governments source transactions on an origin basis, *i.e.*, the seller's place of business. One of the chief stumbling blocks for some states in adopting the Agreement is that it requires destination sourcing, and they have origin sourcing for local sales taxes.

Overall, sales taxes provide about one-third of state revenues.²¹ For the fiscal year that ended June 30, 2006, South Carolina collected \$2,544,980,403 in sales and use taxes. That was 41% of our General Fund Revenue.

Use Taxes and Remote Sales

For consumers, a common expectation is that the retail business selling goods and services knows the applicable sales tax law and collects the correct amount of tax. However, in the case of remote sales (mail order and Internet based sales), the retailer is not always obligated to collect the tax.

When an out of state seller sells an item and ships it to its customer in South Carolina, that seller is required to collect the South Carolina use tax if it has "nexus" with South Carolina. Nexus is a sufficient connection between a state and a taxpayer that allows the state to subject the taxpayer to its taxing jurisdiction without violating the US Constitution or federal law.

Under certain circumstances, a business located outside of a state cannot be required to collect tax on sales shipped or mailed into the state. In *Quill Corp. v. North Dakota*, 502 U.S. 808, 112 S. Ct. 1904, 119 L. Ed. 2d 27 (1992), the U.S. Supreme Court held that a state could not impose sales taxes or use tax collection responsibilities on a company with no physical presence in the state. Quill sent catalogues into the state, and sold merchandise to state residents by accepting mail and telephone orders and delivering goods by common carrier. The Supreme Court stated that since the Commerce Clause prevented states from requiring use tax collection from out of state companies with no

²⁰ Due, John F. and John L. Mikesell. *Sales Taxation*. The Urban Institute Press, 2nd ed., 1994.

²¹ *Streamlining New York's Sales Tax: Examining Requirements for Compliance with the Streamlined Sales and Use Tax Agreement*, Office of Tax Policy Analysis, New York State Department of Taxation and Finance (October 2006).

physical presence in the taxing state, Congress has the power to legislate a different result. Internet companies are treated the same as mail order companies.

Essentially, nexus for sales and use tax purposes requires a physical presence. Examples of physical presence giving rise to Commerce Clause nexus for sales and use tax purposes include, but are not limited to, maintaining (temporarily or permanently) an office, warehouse, distribution house, sales house, other place of business, or property of any kind in the state or having (temporarily or permanently) an agent, representative (including delivery personnel and independent contractors acting on behalf of the retailer), salesman, or employee operating within the state.

Even though some remote sellers may not be legally required to collect tax, their sales are not “tax free.” South Carolina and South Carolina local governments that have a sales tax also impose a use tax. The use tax is complementary to the sales tax. It is imposed on the use, storage, or other consumption of property purchased from an out of state seller that would have been subject to the sales tax if the property had been purchased in South Carolina.²² The use tax is imposed at the same rate as the sales tax. Thus, when an individual or business buys a taxable good or service and is not charged (the sales) tax, they must pay it (the use tax). For more detailed information, see SC Revenue Ruling #06-2 that is attached as Exhibit M.

The purpose of the use tax, in addition to raising revenue, is to eliminate the incentive a South Carolina resident would otherwise have to shop in other states. Without the use tax, a state would lose revenue and place its merchants at a disadvantage. This result occurs in the context of mail order and Internet sales.

When a state cannot require out of state retailers to collect the use taxes on items they sell to its residents, it tries to collect the taxes from each purchaser. The inability of states to collect tax on remote sales is a longstanding concern. The Internet’s potential for rapidly increasing the amount of such sales provides a heightened urgency to this problem. See the discussion of South Carolina sales and use taxes below for steps South Carolina has taken in its efforts to collect use taxes from purchases.

South Carolina Sales and Use Taxes

South Carolina imposes the following state tax rates under the sales and use tax law authorized in Chapter 36 of Title 12:

General Sales and Use Tax Rate:	6%
Accommodations Tax Rate:	7%
900 and 976 Tax Rate:	11%

²² If a person purchases a product in another state and pays that state’s sales tax to the retailer, the purchaser is allowed a credit for the sales tax paid in the other state against the use tax due in South Carolina. If the sales tax paid in the other state on the purchase exceeds the use tax due in South Carolina, no refund is due.

Manufactured Home	5% + 2% for amounts over \$6,000 ²³
Maximum Tax Items ²⁴	5% (Maximum Tax: \$300.00)
Unprepared Food	3% ²⁵
Sales to Persons 85 and Older	5%
Certain Construction Material	4% ²⁶
Durable Medical Equipment ²⁷	5.5% ²⁸

In addition, the sales tax due on the sale in South Carolina to a nonresident of a motor vehicle, trailer, semitrailer, or pole trailer that is to be registered and licensed in the nonresident purchaser's state of residence is the lesser of (a) the sales tax which would be imposed on the sale in the purchaser's state of residence or (b) the tax that would be imposed under Chapter 36 of the South Carolina Code of Laws. No sales tax is due in South Carolina if a nonresident purchaser cannot receive a credit in his resident state for sales tax paid to South Carolina. See SC Information Letter #05-13 attached as Exhibit "K."

The South Carolina Code of Laws also allows the imposition of various types of local sales and use taxes. As such, a county may impose one or several local sales and use taxes. SC Information Letter #07-4, which was issued by the Department of Revenue and is attached as Exhibit "I," provides guidance concerning the various types of local sales and use taxes presently collected by the Department of Revenue. This information letter only addresses the general local sales and use taxes collected by the Department of Revenue on behalf of the counties, school districts, and the Catawba Indian tribal

²³ If the home meets certain energy efficient standards, the 5% tax is capped at \$300 under the maximum tax provisions of Code Section 12-36-2110 and the 2% tax on amounts over \$6,000 does not apply.

²⁴ The maximum tax applies to aircraft (including unassembled aircraft which is to be assembled by the purchaser), motor vehicles, motorcycles, boats, trailers and semitrailers that can only be pulled by a truck tractor, horse trailers, fire safety education trailers, recreational vehicles (including tent campers, travel trailers, park models, park trailers, motor homes, and fifth wheels), self-propelled light constructions equipment limited to a maximum 160 net engine horsepower, manufactured homes, and certain musical instruments and office equipment sold to religious organizations exempt under IRC Section 501(c)(3).

²⁵ On and after November 1, 2007, unprepared food will be exempt from the state sales and use tax, but not local sales and use taxes unless the specific local sales and use tax exempts such food.

²⁶ Effective July 1, 2011, Code Section 12-36-2120(67) exempts construction materials used in the construction of a single manufacturing and distribution facility with a capital investment of at least \$100 million in real and personal property in the State over an 18 month period. However, the exemption will be phased in over several years. Beginning July 1, 2007 the tax rate is 4%. Each July 1st after that the tax rate is reduce by another 1% until such sales are fully exempt beginning July 1, 2011.

²⁷ The lower rate also applies to related supplies.

²⁸ Beginning with the February 15, 2008 forecast by the Board of Economic Advisors ("BEA") of annual general fund revenue growth for the upcoming fiscal year, and annually thereafter, if the forecast of that growth equals at least five percent of the most recent estimate by the BEA of general fund revenues for the current fiscal year, then the applicable state sales and use tax rate imposed on durable medical equipment is reduced, effective the following July first, by one and one-half percent in the first year and by one percent every year thereafter. That reduced rate applies until a subsequent reduction takes effect. If the February fifteenth forecast meets the requirement for a rate reduction, the BEA must certify the result in writing to the Department. On the July first that the rate attains zero, the sale of durable medical equipment will be exempt from both state and local sales and use taxes.

government. It does not address the local taxes on sales of accommodations or on sales of prepared meals that are collected directly by the counties. Most counties impose a 1% sales tax; as of May 1, 2007, ten counties impose more than 1%. In some states, local sales taxes are administered and collected by the state. In South Carolina the Department of Revenue collects all local sales taxes, except local accommodations and hospitality sales taxes. Hospitality sales taxes are taxes on prepared meals. Local accommodations and hospitality sales taxes are administered and collected locally and are usually 3 and 2 percent, respectively. See Code Sections 6-1-700 through 6-1-770 (local hospitality tax) and Code Section 6-1-500 through 6-1-570 (local accommodations tax).

The sales tax is imposed on the sales at retail of tangible personal property and certain services. The use tax is imposed of the storage, use or consumption of tangible personal property and certain services when purchased at retail from outside the state for storage, use or consumption in South Carolina. The services subject to the sales and use tax are:

Furnishing of Accommodations (the state rate for this service is 7%.)

Dry Cleaning and Laundering Services

Electricity

Communication Services (charges for the ways and means for the transmission of the voice or message) including, but not limited to:

Telephone services (not specifically exempted under Code Section 12-36-2120(11)), including telephone services provided via the traditional circuit-committed protocols of the public switched telephone network (PSTN), a wireless transmission system, a voice over Internet protocol ("VoIP"), or any of other method

Teleconferencing Services

Paging Services (See also SC Information Letter #89-28.)

Answering Services (See also SC Information Letter #89-28.)

Cable Television Services

Satellite Programming Services and Other Programming Transmission Services (includes, but is not limited to, emergency communication services and television, radio, music or other programming services)

Fax Transmission Services (See also SC Revenue Ruling #89-14.)

Voice Mail Messaging Services (See also SC Revenue Ruling #89-14.)

E-Mail Services (See also SC Revenue Ruling #89-14.)

Electronic Filing of Tax Returns when the return is electronically filed by a person who did not prepare the tax return (See also SC Revenue Ruling #91-20.)

Database Access Transmission Services (On-Line Information Services), such as legal research services, credit reporting/research services, charges to access an individual website(including Application Service Providers), etc. (not including computer database information services provided by a cooperative service when the database information has been assembled by and for the exclusive use of the members of the cooperative services) (See also SC Revenue Ruling #89-14 and SC Private Letter Ruling #89-21.)

Under a separate imposition section, the following communication services have also been taxed:

Prepaid Wireless Calling Arrangements (sale or recharge at retail) as defined in Code Section 12-36-910(B)(5) (For information on prepaid telephone calling cards that do not come within the definition of prepaid wireless calling arrangements, see SC also Revenue Ruling #04-4.)

900/976 Telephone Service (the State tax rate on this type of communication service is 11%, not 6%.

There are also special imposition sections that taxes the fair market value of tangible personal property when used, stored or consumed by its manufacturer (Code Sections 12-36-910(B)(4) and 12-36-1310(B)(4)) and a special imposition section that taxes transient construction property brought into South Carolina (Code Section 12-36-1320).

Currently, the General Assembly has enacted over 70 specific exemptions from the sales and use tax that can be found in Code Section 12-36-2120, some are for certain products (e.g., newspapers, dental prosthetic devices, food (for some local sales taxes)), uses (e.g., machines used in manufacturing or processing), and purchasers (e.g., the federal government, or charitable hospitals predominately servicing children exempt from property taxes, where care is provided without charge to the patient). In addition, several sales and use tax exemptions can be found in other areas of the South Carolina Code of laws (e.g., SC Code section 58-25-80 exempts Regional Transportation Authorities, and SC Code section 12-11-30 exempts banks from sales taxes, but not use taxes) and some partial exemptions, established in the form of a maximum tax (generally \$300.00), can be

found in Code Section 12-36-2110. Many states exempt sales to state or local government. South Carolina does not. South Carolina has also established a number of exclusions from the tax such as sales for resale (wholesale sales), sales of property used as an ingredient or component part of tangible personal property manufactured for sale or as an ingredient in preparing ready-to-eat food or drink sold at retail. See Code Sections 12-36-60, 12-36-110, 12-36-120, 12-36-140 and 12-36-910(C) for these and other examples, as well as partial exclusions found in Code Section 12-36-90(2). For more information on exclusions and exemptions, see a portion of the Department's Sales and Use Tax Seminar Manual – 2007 provided as Exhibit "O."

For the fiscal year that ended June 30, 2006, South Carolina collected \$2,544,980,403 in sales and use taxes. That was 41% of our General Fund Revenue.

When the Department cannot require out of state retailers to collect the use taxes on items they sell to South Carolinians, it tries to collect the taxes from each purchaser. Many businesses know and understand their use tax obligations and pay their taxes voluntarily. On the other hand, most individual consumers do not know about their use tax responsibility. If it is brought to their attention, they often view it as a new tax and a government intrusion.

The Department of Revenue collects sales and use tax on sales into the state by out-of-state retailers through various programs, including but not limited to:

The Department's "Nexus/Discovery Team" brings into compliance out-of-state taxpayers who are doing business in South Carolina and who have the requisite nexus with South Carolina.

The Department shares and exchanges information with other states on nexus issues as well as purchases by South Carolina residents.

Department auditors, including auditors located out-of-state in large metropolitan areas, audit companies doing business in South Carolina.

All licensed retailers who purchase tangible personal property or services from out-of-state for their own use and not for resale are liable for the tax on such purchases if the out-of-state retailer does not collect the tax. The sales tax return filed by licensed South Carolina retailers has a line for reporting and remitting the tax on such out-of-state purchases.

Businesses that are not retailers that make large purchases from out-of-state can be registered for use tax purposes and thereby file a use tax return to remit the use tax on purchases of tangible personal property or services from out-of-state when the out-of-state retailer does not collect the tax.

Individuals may pay their use tax annually on a line the Department has placed on the Individual Income Tax return.

Some progress has been made in educating the public by putting a use tax line on the individual income tax form. In addition, states share information, so when North Carolina audits a furniture dealer, they will provide the Department with information about furniture shipped to South Carolina. But the problems remain. As our Main Street businesses lose sales to mail order and Internet businesses, South Carolina loses sales and use taxes. The fact that many individuals believe their Internet purchases are tax free encourages them to use the Internet, accelerating the loss of tax revenues and further eroding the business of our Main Street merchants.

The Streamlined Sales Tax Project

The following excerpts from Hellerstein & Hellerstein: *State Taxation* provide some historical background for the Streamlined Sales Tax Project and resulting Agreement that is the focus of this report:

In 1998, Congress joined the debate over state taxation of electronic commerce with its adoption of the Internet Tax Freedom Act (ITFA). Besides imposing limited substantive restraints on the states' power to impose taxes on Internet access or to impose "multiple" or "discriminatory taxes" on electronic commerce, ITFA established the Advisory Commission on Electronic Commerce (ACEC or the Commission). Congress charged the Commission with conducting a thorough study of federal, state, local, and international taxation of transactions using the Internet and other comparable activities. Among the state tax issues that Congress directed the Commission to study ... were:

1. An examination of model state legislation that would (a) provide uniform definitions of categories of property, goods, services, or information that are subject to or exempt from sales or use taxes, and (b) ensure that Internet-related services would be treated in a tax-neutral manner relative to other sales.
2. An examination of the effects of taxation (and the absence of taxation) of all interstate sales transactions on retail businesses and on state and local governments, including the efforts of state and local governments to collect sales and use taxes on in-state purchases from out-of-state sellers.
3. An examination of ways to simplify federal, state, and local taxes on telecommunications services.

Congress directed the Commission to prepare a report within eighteen months (by April 2000) reflecting the results of its study and including legislative recommendations.

... [T]he ACEC never reached consensus on the key issues it examined because of the deep political and philosophical divisions among its members. Therefore, it never made any recommendations because of the requirement that any Commission recommendation command a two-thirds supermajority. Accordingly, the Commission's most important legacy was the spate of proposals it stimulated when, in the course of its deliberations, it invited the public to submit proposals for resolving the problems raised by state and local taxation of electronic commerce. Indeed, one of these proposals—Utah Governor and Commission member Michael Leavitt's proposal for a “streamlined sales tax system” —established the framework for the formation of the SSTP [Streamlined Sales Tax Project].

Speaking for at least eight ACEC commissioners, Governor Leavitt, who was also serving as chairman of the National Governors' Association, endorsed a proposal under which “states and localities agreed to undertake an extensive and comprehensive plan to simplify antiquated state sales and use tax systems in exchange for the clear right to collect those taxes.”

* * * *

Governor Leavitt's proposal also recommended that Congress enact legislation authorizing the states to develop and enter into an Interstate Sales and Use Tax Compact “[t]o implement this streamlined sales tax system.” The proposed legislation contemplated that states joining the Compact would be required to adopt a simplified sales tax system embodying the criteria identified above. States so doing would then be authorized to require remote sellers exceeding the sales volume threshold to collect use tax on all taxable sales into a state.

In March of 2000, the Streamlined Sales Tax Project (Project) was organized by participating states to simplify and modernize the state sales and use tax system with particular emphasis on easing the burden of multistate retailers. The key features of this “streamlined” sales tax system were intended to, and do, include:

- **Uniform definitions within tax laws.** Participating states agree to use the common definitions for key items in the tax base and will not deviate from these definitions. As states move from their current definitions to the Agreement’s definitions, a certain amount of impact on state revenues is inevitable. However, it is the stated intent of the Project to provide states

with the ability to closely mirror their existing tax bases through common definitions.

- **Rate simplification.** States are allowed one state rate and a second state rate in limited circumstances (*e.g.*, food and drugs). Each local jurisdiction is allowed one local rate. A state or local government may not choose to tax telecommunications services, for example, at one rate and all other items of tangible personal property or taxable services at another rate. State and local governments accept responsibility for notice of rate and boundary changes at restricted times. States will provide an on-line rate/jurisdiction database to simplify rate determinations.
- **State level tax administration of all state and local sales and use taxes.** Each state provides a central point of administration for all state and local sales and use taxes and the distribution of the local taxes to the local governments. In general, state and its local governments use common tax bases.
- **Uniform sourcing rules.** The states have uniform rules for how they source transactions to state and local governments. The uniform rules are generally destination/delivery based and uniform for tangible personal property, digital property, and services.
- **Simplified exemption administration for use- and entity-based exemptions.** Sellers are relieved of the “good faith” requirements that exist in many states’ law and are not be liable for uncollected tax. Purchasers are responsible for paying the tax, interest and penalties for claiming incorrect exemptions. States will use a uniform exemption certificate in paper and electronic form.
- **Uniform audit procedures.** Sellers who participate in one of the certified Streamlined Sales Tax System technology models will either not be audited or will have limited scope audits for sales taxes, depending on the technology model used.
- **State funding of the system.** To reduce the financial burdens on sellers who voluntarily collect the tax for states with which they don’t have nexus, the states will assume responsibility for funding some of the technology models for them.

States were motivated by the complexity of the present system, the burden that the system imposed on retailers, and the threat the growth of Internet sales posed to the future of the sales tax and the vitality of local retailers, particularly if steps were not taken to simplify the system to permit (or require) out of state retailers to collect use taxes. In addition, the

states believed that computer technology could be used to reduce the compliance burden on multistate retailers, and that reduction would, perhaps, lead to more voluntary compliance by out of state retailers, and, possibility to congressional or judicial relaxation of the constitutional rules that now prohibit the states from requiring out of state retailers to collect use taxes on interstate sales.

By 2005, forty-four states and the District of Columbia (all states with sales taxes other than Colorado) were participating in the Project process. In addition, the Project had input from the National Governors Association, the National Conference of State Legislatures, Multistate Tax Commission, Federation of Tax Administrators, and a significant number of business representatives, including the Council on State Taxation (COST), which represents 530 multistate corporations.

Streamlined Sales Tax Implementing States

In November 2001, model legislation called the Streamlined Sales and Use Tax Act was developed separately by the National Conference of State Legislatures and the Project. States passing either version of the Act became part of a temporary governance structure called the Streamlined Sales Tax Implementing States (Implementing States). The Implementing States' objective was to finalize the streamlined system that had been under development by the Project.

In November 2002 delegates from the 35 Implementing States voted to approve the Streamlined Sales and Use Tax Agreement. Since then the Agreement has been amended 8 times, the last time on December 14, 2006.

On June 24, 2002, South Carolina enacted Chapter 35 of Title 12, the Simplified Sales and Use Tax Administration Act. This Act made South Carolina an Implementing State. SC Code Section 12-35-40 provides that South Carolina would be represented in multistate discussions by four delegates, the Chairman of the House Ways and Means Committee or his designee, the Chairman of the Senate Finance Committee or his designee, one delegate appointed by the Governor from the business community, and the Director of the Department of Revenue or his designee.²⁹

SC Code Section 12-35-50 states that the Department shall enter into the Streamlined Sales and Use Tax Agreement, but it does not amend any of South Carolina's sales and use tax statutes, and it does not commit South Carolina to amend its sales and use tax law to meet the requirements of the Agreement.

²⁹ The Director of the Department of Revenue's designee is Tim Donovan, the Manager of the Department's Foreign Audit Section.

THE GOVERNING BOARD
Member States of the Streamlined Sales and Use Tax Agreement

The Agreement provided that when 10 states representing 20 percent of the population of states imposing a sales tax are certified as having conformed their states' laws to the provisions in the Agreement, the Agreement becomes effective and these states form the Streamlined Sales Tax Governing Board ("Governing Board").

On October 1, 2005, a Governing Board of the 13 initial full member states became effective. The Governing Board is a non-profit corporation under the laws of Indiana. The Bylaws set forth the operation and administration of the Governing Board, its committees and advisory councils in accordance with the Agreement.

Two categories of member states currently exist on the Agreement's Governing Board. Full member states are those that were found to be in substantial conformity with the provisions of the Agreement. Associate member states are either, (a) states whose conforming changes are sufficient to comply with each provision in the Agreement but the statutory changes have not yet taken effect; or, (b) states whose conforming changes are in effect but do not substantially comply with each provision in the Agreement. Associate member states not substantially compliant with the Agreement must re-petition for full membership by January 1, 2008. The member states are listed below.

Member States of the Streamlined Sales and Use Tax Agreement as of July 24, 2007			
Full Member States (15)		Associate Member States (7)	
Indiana	New Jersey	Arkansas	Utah*
Iowa	North Carolina	Nevada	Ohio
Kansas	North Dakota	Wyoming	Washington
Kentucky	Oklahoma	Tennessee	
Michigan	South Dakota		
Minnesota	West Virginia		
Nebraska			
Rhode Island			
Vermont			

The number of full member states will increase in the near future. Associate member state Washington will become a full member effective January 1, 2008. Associate member states Arkansas and Wyoming have filed petitions for full member state status effective January 1, 2008. However, Utah and Ohio may lose associate member status January 1, 2008 and Tennessee has enacted conforming legislation effective July 1, 2009.

Streamlined Sales Tax Advisory Councils

The Agreement charges the Governing Board with creating a State and Local Advisory Council (SLAC) and recognizing a Business Advisory Council (BAC).

SLAC advises the Governing Board on matters pertaining to the administration of the Agreement.³⁰ These matters may include admission of states into the Agreement, drafting issue papers to explain provisions in the Agreement, or other issues directed by the Governing Board.

South Carolina is a member of SLAC by virtue of its status as a participating state in the Streamlined Sales Tax Project. In effect, SLAC has assumed the role of the now-defunct Project.

In August 2006 the Governing Board amended the Agreement to establish a new category of “Advisor States” for former Implementing States.

BAC also advises on matters pertaining to the Agreement.³¹ The BAC provides a forum for members of the private sector to express any concerns or suggestions related to the Agreement.

³⁰The SLAC chair is Diane Hardt of the Wisconsin Department of Revenue. The SLAC Steering Committee members are Richard Dobson (KY), Sherry Harrell (TN), Craig Rook (NJ), Tom Kimmett (PA), Cindi Yates (WA), Mike Bailey (representing the Government Finance Officers Association), and Sonny Brasfield (representing the National Association of Counties).

³¹The BAC Executive Committee Members are Warren Townsend, (Wal-Mart), Meredith Garwood (Time Warner Cable), Stephen Kranz (Council on State Taxation), and Deborah Bierbaum (AT&T).

IV. Streamlined Sales Tax Agreement and What We Need To Do To Comply

A. Tax Base

1. Uniform State and Local Tax Base

Agreement Requirement

A uniform sales and use tax law among the states is a difficult, if not an impossible, task. However, the Agreement attempts to promote uniformity, to an extent, by requiring that the state and local tax base be uniform within each state and requiring each state to adopt the definitions within the Agreement. The definitions will be discussed in Section 2 of this “Tax Base” section.

One of the difficulties of sales and use taxation for a seller is multiple tax bases within a state. In other words, the state sales and use tax base is different than the tax base for one or more of the local sales and use taxes and the local tax base for one local tax is different from the tax base for another local tax.

To simplify this area of sales tax administration, Section 302 of the Agreement requires a single state and local tax base (with some exceptions), and states:

After December 31, 2005, the tax base for local jurisdictions shall be identical to the state tax base unless otherwise prohibited by federal law. This section does not apply to sales or use taxes levied on the retail sale or transfer of motor vehicles, aircraft, watercraft, modular homes, manufactured homes, or mobile homes.

Current South Carolina Law

The South Carolina Code allows the imposition of various types of local sales and use taxes. As such, a county may impose one or several local sales and use taxes. While most of these local sales and use taxes provide the same exemptions for certain sales and purchases, there are some differences. See SC Information Letter #07-4³² which provides guidance concerning the various types of local sales and use taxes presently collected by the Department of Revenue and the types of exemptions allowed under each tax. This information letter only addresses the general local sales and use taxes collected by the Department of Revenue on behalf of the counties, school districts, and the Catawba Indian tribal government. It does not address the local taxes on sales of accommodations or on sales of prepared meals that are collected directly by the counties.

³² SC Information Letter #07-4 was issued by the Department of Revenue and is included in this report as Exhibit “I.”

While these taxes largely conform to the State sales tax base, there are several areas of difference. The differences concern:

- Exemptions for food in certain local taxes.
- Exemptions for casual excise tax items in certain local taxes.³³
- Exemptions for maximum tax items in all local taxes (See also B.2. on “Caps and Thresholds.”).

Statutory Changes Needed for South Carolina to Comply

In order for South Carolina to establish the same tax base for state and local taxes in accordance with the Agreement, South Carolina would need to amend the state sales and use tax and/or local sales and use taxes (Local Option Tax, Capital Projects Tax, Transportation Tax, Personal Property Tax Relief Tax, and all School Bond–Property Tax Relief Taxes) to ensure they have the same tax base.

The following changes must be made in order to establish a uniform state and local tax base in South Carolina:

- An amendment to various statutes (state and local) so that the state tax and all local taxes either (1) exempt unprepared food in accordance with the definitions and provisions of the Agreement, (2) tax unprepared food in accordance with the definitions and provisions of the Agreement, or (3) exempt such unprepared food from the state tax, but tax such unprepared food under all local sales and use taxes.³⁴ Presently, some local taxes exempt food eligible to be purchased with USDA food stamps.³⁵
- An amendment to various statutes (state and local) so that the state tax and all local taxes either exempt certain casual excise tax items or tax these casual excise tax items.

³³ The casual excise tax is not a sales tax; however, it is included in the same chapter of the code of laws as the state sales and use tax. The exemption referenced here is an exemption provided in some but not all local sales and use taxes for items subject to the casual excise tax.

³⁴ Section 308 of the Agreement provides a limited exception to uniformity that would allow a member state to exempt “food” or “drugs,” as defined by the Agreement, from the state tax by applying a 0% state tax rate, but to tax such “food” or “drugs” at the local level. However, all local jurisdictions must tax these items under this alternative. Some local jurisdiction may not exempt these items while others tax them as is presently the case in South Carolina with respect to ‘food.’

³⁵ If South Carolina participates in the Agreement, it must use the definitions and provisions established in the Agreement; therefore, the South Carolina could no longer use of the USDA food stamp program in determining the taxation of unprepared food for sales tax purposes. See also Section A.2. of this report concerning “Definitions.”

The casual excise tax is a tax, separate from the sales and use tax, imposed on the issuance of a certificate of title or other proof of ownership for motor vehicles, motorcycles, boats, motors, and airplanes when they are sold by non-retailers. If a retailer sells these items, then the sales tax or use tax would apply and not the casual excise tax.

Presently, all local taxes exempt maximum tax items, while some local taxes also exempt casual excise tax items. The local taxes that do not exempt casual tax items are therefore imposing the tax on trailers that can be pulled by a vehicle other than a truck tractor, pole trailers, and boat motor not attached to the boat at the time of the sale. These items are exempt from the local taxes which specifically exempt both maximum tax items and casual tax items.

In order to comply with the Agreement, this discrepancy must be resolved so that trailers that can be pulled by a vehicle other than a truck tractor, pole trailers, and boat motor not attached to the boat at the time of the sale are either exempt from both state and all local sales and use taxes or subject to tax under state and all local sales and use taxes.

- An amendment to various statutes (state and local) so that the state tax and all local taxes either exempt certain maximum tax items³⁶ or tax certain maximum tax items. Maximum tax items are those items for which the General Assembly has established a maximum sales tax or use tax due with respect to the sale or purchase of certain items. In most cases, the maximum tax due is \$300.00

The items subject to the maximum tax, as listed in Code Section 12-36-2110, are aircraft (including unassembled aircraft kits), motor vehicles, motorcycles, boats, trailers and semitrailers that can only be pulled by truck tractors, horse trailers, recreational vehicles (tent campers, travel trailers, park models, park trailers, motor homes, and fifth wheels), self-propelled light construction equipment limited to a maximum 160 net engine horsepower, manufactured homes, certain musical instruments and office equipment purchased by religious organization, and fire safety education trailers.

Since the Agreement does not apply to motor vehicles, watercraft, aircraft, and modular and manufactured homes, the maximum tax items in question are trailers and semitrailers pulled by a truck tractor, horse trailers, non-motorized recreational vehicles, and musical instruments and office equipment purchased by a religious organization. Therefore, in order to comply with the tax base uniformity provisions of the Agreement, South Carolina must either exempt

³⁶ See also discussion on “Caps and Thresholds” in Section B - “Tax Rates.”

these items from the state tax and all local taxes or tax these items under state tax and local taxes.

(Note: Arguments may be made that the provisions of the Agreement may not be applicable to the Local Hospitality Taxes (a local tax on prepared meals) and Local Accommodations Taxes presently collected directly by counties and municipalities. The decision will rest with the Governing Board.)

2. Definitions

Agreement Requirement

The Agreement contains numerous administrative and product definitions, with the product definitions falling within five basic categories of (1) clothing, (2) computer-related products, (3) food and food products, (4) health care products, and (5) telecommunications.

In discussing the various categories of product definitions, Walter Hellerstein and John A. Swain, in *Streamlined Sales and Use Tax 2006/2007*, (Warren, Gorham and Lamont)³⁷ state:

These categories were the first to be defined because states traditionally exempt some or all of these items, because computer-related items frequently raise the issue of whether the product is intangible and therefore excludable from the tax base, and because of intense business community interest in these categories. In many instances, [the Agreement] first defines broad product categories and then creates various subcategory definitions. Typically, subcategories are chosen based on existing exemption patterns so that a member state may re-create its existing tax base as accurately as possible. For example, the general definition of “food and food ingredients” includes candy, but candy is also separately defined in the event that a member state wants to treat candy differently from other food (i.e., exempting food generally but taxing candy), as is currently done in several jurisdictions.

Technology plays an important role in accomplishing the goals of the Agreement. Specialized computer software and other technology will simplify the collection and reporting of sales tax for multi-state sellers; however, this cannot be accomplished without the adoption of uniform definitions. For example, if states define the term “sales price” differently, then simplification is not achieved since the multistate seller must base the tax on a different amount in each state.

³⁷ This publication will be hereinafter referred to as *Hellerstein and Swain*.

Section 327 of the Agreement promotes uniformity by requiring a state to use a definition in the Agreement if it uses a term in its tax law or regulations that is defined in the Library of Definitions. A state is required to incorporate the Agreement's meaning of the term into its own tax law or regulations.

Section 327 of the Agreement requires that:

Each member state shall utilize common definitions as provided in this section. The terms defined are set out in the Library of Definitions, in Appendix C of this Agreement. A member state shall adhere to the following principles:

- A. If a term defined in the Library of Definitions appears in a member state's sales and use tax statutes or administrative rules or regulations, the member state shall enact or adopt the Library definition of the term in its statutes or administrative rules or regulations in substantially the same language as the Library definition.
- B. A member state shall not use a Library definition in its sales or use tax statutes or administrative rules or regulations that is contrary to the meaning of the Library definition.
- C. Except as specifically provided in Section 316 and the Library of Definitions, a member state shall impose a sales or use tax on all products or services included within each definition or exempt from sales or use tax all products or services within each definition.

The Agreement contains nearly 90 definitions. Many of these definitions are contained in the Agreement's Library of Definitions (Appendix C) which divides its definitions into the following three categories:

Part I Administrative definitions including tangible personal property. Terms included in this Part are core terms that apply in imposing and administering sales and use taxes.

Part II Product definitions. Terms included in this Part are used to exempt items from sales and use taxes or to impose tax on items by narrowing an exemption that otherwise includes these items.

Part III Sales tax holiday definitions. Terms included in this Part are core terms that apply in imposing and administering sales and use taxes during sales tax holidays.

Based on the above, the member states of the Agreement have established the following definition as of the date of this report:

Part I - Administrative definitions include:

bundled transaction
delivery charges
direct mail
lease or rental
purchase price
retail sale or sale at retail
sales price
telecommunications nonrecurring charges
tangible personal property

Part II - Product definitions include:

Clothing Related

clothing
clothing accessories or equipment
protective equipment
sport or recreational equipment

Computer Related

computer;
computer software
delivered electronically
electronic
load and leave

Food and Food Product Related

alcoholic beverages
candy
dietary supplement
food and food ingredients
food sold through vending machines
prepared food
soft drinks
tobacco

Health Care Related

Drug
durable medical equipment
grooming and hygiene products
mobility enhancing equipment
over-the-counter drug
prescription

prosthetic device

Telecommunications Related

ancillary services
conference bridging services
detailed telecommunications billing services
directory assistance
vertical service
voice mail service
telecommunications service
800 service
900 service
fixed wireless service
mobile wireless service
paging service
prepaid calling service
prepaid wireless calling service
private communications service
value added non-voice data service
coin-operated telephone service
international
interstate
intrastate
pay telephone service
residential telecommunications service

Part III - Sales Tax Holiday definitions include:

eligible property
layaway sale
rain check
school supply
school art supply
school instructional material
school computer supply

Other definitions contained in the Agreement (that are not a part of the “Library of Definitions”) include:

Agent
Air-to-ground radiotelephone service
Call-by-call basis
Certified automated system
Certified service provider

Communications channel
Confidential taxpayer information
Customer
Customer channel termination point
Entity-based exemption
Home service provider
Mobile telecommunications service
Model 1 Seller
Model 2 Seller
Model 3 Seller
Person
Place of primary use
Post-paid calling service
Private communication service
Purchaser
Receive and receipt
Registered under this agreement
Seller
Service address
State
Transportation equipment
Use-based exemption

In addressing these definitions, several issues arise – exemptions, exclusions, and replacement taxes.

A state, in order to comply with the definitions set forth in the agreement, may need to:

- Eliminate an exemption or exclusion³⁸ and tax the sale of the item and increase revenue; or
- Comply with the Agreement’s definition and either increase revenue or lose revenue; or
- If complying with the Agreement’s definition will cause a loss in revenue, the state may be able to create a new “replacement” tax outside of its sales and use tax so that the change is revenue neutral. However, the Governing Board is considering restrictions on a state’s ability to create replacement

³⁸ An exemption concerns a sale at retail, and as a retail sale, the transaction would be taxable except for the exemption provided by the General Assembly.

An exclusion is typically a transaction that the General Assembly has removed from taxation so as to not include it as a “retail sale” or a part of a “retail sale.” Therefore, since it is not a retail sale, or part of one, it is not taxable since the sales and use tax only applies to retail sales.

taxes. See the discussion of “Replacement Taxes” in Section XII – Current Issues.

In discussing the issue of “replacement” taxes, *Hellerstein and Swain* states:

Substitute taxes raise two important questions. First, is a member state that adopts a substitute tax in compliance with [the Agreement]? Second, even if it is, will substitute taxes create a sales and use tax environment, broadly construed, that continues to impose a burden on interstate commerce under *Quill*? In addressing these questions, one should draw a distinction between substitute taxes that potentially place additional burdens on remote sellers, such as the Minnesota fur tax, and substitute taxes that are enforceable only against the local buyer, such as the North Carolina manufacturers’ privilege tax. Because [the Agreement] concerns itself largely with seller issues, achieving uniformity with respect to tax collection obligations that fall solely on buyers is arguably outside its scope and purpose. Furthermore, the number of substitute taxes enacted by a particular state or by the states collectively may be relevant.

The issue of replacement taxes has generated much discussion since it is viewed by some as circumventing the purpose of the Agreement. However, as discussed above, some replacement taxes do not place a burden on the remote seller. In the example cited in the above quote, the privilege tax on manufacturers is imposed on the buyer – the manufacturer – and does not impose a burden on remote sellers or interstate commerce while a tax that is imposed upon or requires the seller to collect the tax from the purchaser does create a burden on the remote seller. Although replacement taxes may be viewed as contrary to the purpose of simplification, it should also be remembered that another purpose was, and is, to allow states to join the Agreement and maintain their tax base. Most of the arguments favoring restricting replacement taxes are based on the understandable desire of businesses to pay less in taxes. These arguments favor allowing replacement taxes that permit lower taxes than would otherwise be allowed by the Agreement, and they usually do not object to replacement taxes for services that most states already tax outside of their sales tax (e.g., accommodations or lodging taxes). They object to taxes that increase taxes beyond what the Agreement would allow, whether to maintain the state’s tax base or actually increase the state’s tax base.

Two facts should be kept in mind when considering this discussion. First, replacement taxes are not part of the Agreement; therefore, a business without a retail location in the state does not need to collect or pay such replacement taxes even if they constitute a type of “sales” tax. Second, businesses with retail locations in a state may have the influence, through the jobs they create, the products and services they purchase, and the taxes they already pay, to effectively prevent a state from overburdening in-state businesses with multiple replacement taxes, the filing of multiple tax returns, and multiple tax audits.

See discussion of “Replacement Taxes” in Section XII – Current Issues.

Current South Carolina Law

The South Carolina sales and use tax law contains numerous definitions for purposes of imposition of the tax on tangible personal property and certain specific services, exemptions or exclusions from the tax, and the administration of the tax. These definitions are mostly found in the statute; however, some definitions are a part of various sales and use tax regulations that have been approved by the General Assembly.

Statutory Changes Needed for South Carolina to Comply

The Agreement would require South Carolina to adopt approximately 90 uniform definitions. Some of these changes would require increasing or decreasing the tax base. It would also require the consideration of developing new exemptions or exclusions so exclusions lost through definitional changes are not eliminated, or the creation of replacement taxes.

The following outlines a few of the major issues that will need to be addressed with respect to definitions in the Agreement.

Software: South Carolina presently taxes software (prewritten or custom) when delivered in tangible form and does not tax software (prewritten or custom) when delivered electronically. The Agreement includes prewritten software within the definition of tangible personal property; therefore, prewritten software, whether in tangible form or delivered electronically, will be subject to the tax unless the General Assembly exempts it (the Agreement allows the exemption of all prewritten software or a limited exemption for prewritten software delivered electronically). Custom software would not be taxed under the Agreement unless the General Assembly imposed the tax on the service of creating and selling custom software.

Communications: South Carolina presently imposes the sales and use tax on “charges for the ways and means for the transmission of the voice or messages” and includes such communications within the definition of “tangible personal property.” An advisory opinion issued by the Department, SC Revenue Ruling #06-8,³⁹ lists the following services as subject to the tax under this imposition.

³⁹ SC Revenue Ruling #06-8 is an update of SC Revenue Ruling #04-15. SC Revenue Ruling #06-8 “summarizes” longstanding Department opinion concerning the taxability of various communication services and attempts to list as many communication services as possible that the Department has held in the past as subject to the tax, whether through formal advisory opinions, audits or informal advice provided to taxpayers. The references in the list provided are a reference to a prior advisory opinion issued by the Department which held the particular service subject to the tax.

Telephone services (not specifically exempted under Code Section 12-36-2120(11)), including telephone services provided via the traditional circuit-committed protocols of the public switched telephone network (PSTN), a wireless transmission system, a voice over Internet protocol ("VoIP"), or any of other method

Teleconferencing Services

Paging Services (See also SC Information Letter #89-28.)

Answering Services (See also SC Information Letter #89-28.)

Cable Television Services

Satellite Programming Services and Other Programming Transmission Services (includes, but is not limited to, emergency communication services and television, radio, music or other programming services)

Fax Transmission Services (See also SC Revenue Ruling #89-14.)

Voice Mail Messaging Services (See also SC Revenue Ruling #89-14.)

E-Mail Services (See also SC Revenue Ruling #89-14.)

Electronic Filing of Tax Returns when the return is electronically filed by a person who did not prepare the tax return (See also SC Revenue Ruling #91-20.)

Database Access Transmission Services (On-Line Information Services), such as legal research services, credit reporting/research services, charges to access an individual website(including Application Service Providers), etc. (not including computer database information services provided by a cooperative service when the database information has been assembled by and for the exclusive use of the members of the cooperative services) (See also SC Revenue Ruling #89-14 and SC Private Letter Ruling #89-21.)

Under a separate imposition section, the following communication services have also been taxed:

Prepaid Wireless Calling Arrangements (sale or recharge at retail) as defined in Code Section 12-36-910(B)(5) (For information on prepaid telephone calling cards that do not come within the definition of prepaid wireless calling arrangements, see SC also Revenue Ruling #04-4.)

900/976 Telephone Service (The State tax rate on this type of communication service is 10% (11% beginning June 1, 2007), not 5% (or 6% beginning June 1, 2007).)

The Agreement contains a multitude of definitions with respect to “telecommunication services” for purposes of sourcing telecommunication services. In addition, unlike South Carolina, the Agreement’s definition of “tangible personal property” does not include such communications.

The South Carolina statute imposes the tax upon “charges for the ways and means for the transmission of the voice or messages,” and does not use the term “telecommunications.” Thus, it would appear that South Carolina’s imposition is unaffected by the Agreement.

However, there are issues that cloud this determination. First, as stated above, South Carolina’s definition includes “communications” and the Agreement’s definition for “tangible personal property” does not include “communications” or “telecommunications.” Second, the South Carolina law does contain provisions for sourcing “telecommunications” and these provisions also define and use several other terms (not “telecommunications”) that are also defined in the Agreement (e.g., “prepaid calling service,” “service address,” etc.)

While an argument could be made that the sourcing only apply to “telecommunication” taxed under the imposition upon “charges for the ways and means for the transmission of the voice or messages,” taxpayers could argue otherwise. For example, since the Agreement’s definition for “telecommunications service” states it is “the electronic transmission ... of voice ... between and among points,” taxpayers could argue that South Carolina’s imposition on the “ways or means for the transmission of the voice or message” is “telecommunications” in light of the reference to telecommunications in the state’s sourcing provisions. However, the strongest argument that this imposition is unaffected by the Agreement, is that the Agreement only requires a state to follow its definitions if the state actually uses the term in its statute. This would indicate that only “telecommunications” defined in the Agreement fall within the South Carolina sourcing provisions. (Note: South Carolina would be required to amend its telecommunication sourcing provisions to comply with the Agreement’s sourcing provisions.)⁴⁰

Finally, the Agreement is subject to change. For example, the Agreement could be amended to require all member states to use the term “telecommunications.” when imposing the sales and use tax upon any type of communications service

⁴⁰ Sourcing is a term used to describe which jurisdiction, state and local, that a tax is assigned to in order to determine which jurisdiction receives the revenue from a particular transaction.

regardless of how the imposition of such a tax is worded. While this possibility may appear remote, the Agreement and the direction of the initial project have changed and broadened over the last several years.

Based on the above, South Carolina could make only minor adjustments to its statute under the presumption that its imposition is relatively unaffected by the Agreement. Or in an abundance of caution in order to ensure revenue from communications services are maintained and truly unaffected, South Carolina could create a replacement tax for communications. However, the solution to create a “replacement” communications tax would cause some taxpayer to file more than one return – a new communications tax return and the sales tax return for sales of tangible personal property. Or, South Carolina could adopt the Agreement’s definition of “telecommunications” and add a special imposition to also tax the various “communications services” it is presently taxing that are not within the Agreement’s “telecommunications” definition.

Bundled Transaction: While the definition for a bundled transaction applies to all sales tax transactions, the Agreement allows the state to limit its application to certain types of transactions. At this time, South Carolina only applies similar rules for “bundled transactions” to communication services. It appears that South Carolina would have to modify its communication services “bundled transaction” rules and definitions, but that it still could limit such rules to communication services.

It is important to remember that the Agreement is subject to change and that a future amendment could require the state to apply a “bundled transaction” rule to additional or all transactions. This is significant because the ability to unbundle a transaction allows the seller to reduce the tax base – the amount upon which the tax is calculated - and thereby reduce state revenue.

Exemptions: The Agreement would require South Carolina to amend various exemptions to address Agreement definitions. The amendment of these exemptions would not only require South Carolina to use the definitions in the Agreement, but it may also require a re-wording of the exemption. Depending of the exemption and how it is re-worded, such changes may increase or decrease revenues and may affect who is or is not entitled to the exemption. See the “Statutory Changes Needed for South Carolina to Comply” under this Section 2 – “Definitions” for examples of South Carolina sales and use tax exemptions that may be affected by the Agreement definitions.

Exclusions: The Agreement would require South Carolina to amend various exclusions to address Agreement definitions. The amendment of these exclusions would not only require South Carolina to use the definitions in the Agreement, but it may also require a re-wording of the exclusion. Depending of the exclusion and

how it is re-worded, such changes may increase or decrease revenues and may affect who is or is not entitled to the exclusion. Examples of South Carolina sales and use tax exclusions that may be affected by the Agreement definitions include:

12-36-60 – exclusion for cooperative service online database charges

12-36-90 – exclusions for motor vehicles operated with dealer, transporter, manufacturer or education license plates, charges for governmental permits with respect to communication charges; solid waste excise fees, late payment charges by certain utilities, and environmental surcharges imposed on drycleaning charges

12-36-910(C) – exclusions for charges for data processing services

Withdrawals for Use: Presently, South Carolina law defines the term “retail sale” to include “withdrawals for use.” A “withdrawal for use” is simply the use of an item by a retailer who purchased it tax free in order to resell it but who later decided to use it. This provision makes sure retailers pay the tax on items they use. “Withdrawals for use” are subject to the tax pursuant to the definition of “gross proceeds of sale” based on the fair market value of the item. The Agreement’s definition of “retail sale” does not include “withdrawals for use;” therefore, a new imposition section will be needed to ensure that “withdrawals for use” by retailers are still taxed

Administrative Definitions: The Agreement will require the revising of many administrative definitions, such as the definitions for “gross proceeds of sales,” “tangible personal property,” “sale,” “retail sale,” and “seller.” As a result, the General Assembly may need to enact additional definition or imposition sections to ensure that the South Carolina tax base remains consistent, as much as possible, with the present law.

It is important to remember that many other changes would be required in order to comply with the Agreement. Some of these changes may also be considered “major” changes – depending of the perspective of the person (taxpayer, legislator, tax administrator) reviewing the change. These changes will result in a major overhaul of the statute – the organization, the terminology used, the applicable exemption and exclusions, and the possibility of removing the taxation of certain items or services from the sales and use tax to create new “substitute” or “replacement” taxes.

3. Exemptions – Enacting

Agreement Requirement

As part of the effort to simplify reporting for multistate sellers, the Agreement requires all member states to use uniform definitions for many products typically exempted by states. Presently, many states may exempt a product, such as clothing or food or drugs, but each state has its own definition as to what is or is not included in these items.

When enacting exemptions, the Agreement requires member states to adopt uniform product definitions found in the Agreement. The specific requirement of the Agreement is found in Section 316, and states:

- A. A member state may enact a product-based exemption⁴¹ without restriction if the Agreement does not have a definition for the product or for a term that includes the product. If the Agreement has a definition for the product or for a term that includes the product, a member state may exempt all items included within the definition but shall not exempt only part of the items included within the definition unless the Agreement sets out the exemption for part of the items as an acceptable variation.
- B. A member state may enact an entity-based or a use-based exemption⁴² without restriction if the Agreement does not have a definition for the product whose use or purchase by a specific entity is exempt or for a term that includes the product. If the Agreement has a definition for the product whose use or specific purchase is exempt, a member state may enact an entity-based or a use-based exemption that applies to that product as long as the exemption utilizes the Agreement definition of the product. If the Agreement does not have a definition for the product whose use or specific purchase is exempt but has a definition for a term that includes the product, a member state may enact an entity-based or a use-based exemption for the product without restriction.
- C. For purposes of complying with the requirements in this

⁴¹Section 209 of the Agreement defines a “product based exemption” as “[a]n exemption based on the description of the product and not based on who purchases the product or how the purchaser intends to use the product.”

⁴² Section 204 of the Agreement defines an “entity-based exemption” as “[a]n exemption based on who purchases the product or who sells the product. An exemption that is available to all individuals shall not be considered an entity-based exemption.” Section 214 of the Agreement defines a “use-based exemption” as “[a]n exemption based on a specified use of the product by the purchaser.”

section, the inclusion of a product within the definition of tangible personal property is disregarded.⁴³

Product definitions are listed in Appendix C of the Agreement, and include the following:

Clothing Related

clothing
clothing accessories or equipment
protective equipment
sport or recreational equipment

Computer Related

computer;
computer software
delivered electronically
electronic
load and leave

Food and Food Product Related

alcoholic beverages
candy
dietary supplement
food and food ingredients
food sold through vending machines
prepared food
soft drinks
tobacco

Health Care Related

Drug
durable medical equipment
grooming and hygiene products
mobility enhancing equipment
over-the-counter drug
prescription
prosthetic device

Telecommunications Related

ancillary services
conference bridging services
detailed telecommunications billing services
directory assistance
vertical service
voice mail service

⁴³These provisions are in effect through December 31, 2007, at which time amended requirements will take effect.

telecommunications service
800 service
900 service
fixed wireless service
mobile wireless service
paging service
prepaid calling service
prepaid wireless calling service
private communications service
value added non-voice data service
coin-operated telephone service
international
interstate
intrastate
pay telephone service
residential telecommunications service

The two most important points to remember about enacting an exemption or continuing to exempt a product under the Agreement are:

- If a state exempts a product for which the Agreement has a definition for a product or for a term that includes the product, the state must exempt all items within each definition and cannot tax only part of the items included within the definition (unless specifically allowed by the Agreement).
- If a state has an entity-based or use-based exemption that includes a product defined by the Agreement, then the state must use the Agreement's definition for the exemption.

It is important to note that adopting the uniform definitions of the Agreement will change how individual items are treated in different states.⁴⁴ As additional products are defined, each state's choices with respect to that product category are limited to that definition.

Current South Carolina Law

South Carolina provides numerous exemptions from the tax. Many of these exemptions exempt products that, in whole or in part, are defined in the Agreement. For example, the General Assembly has authorized exemptions involving in some manner food, clothing, drugs, prosthetic devices, computers, and computer software.

⁴⁴Hardt, Diane and Doug Lindholm. *A Lawmaker's Guide to the Streamlined Sales Tax Project*. The Deloitte & Touche Center for Multistate Taxation, 2002, page 6.

Note: In Act No. 388 of 2006, Part V, Section 1, the General Assembly enacted legislation requiring it to review the sales tax exemptions in Code Section 12-36-2120 no later than its 2010 session. After the initial review, the General Assembly must review these exemptions as it deems appropriate but not later than its session every 10 years after the first review. In addition, a seven member Joint Sales Tax Exemptions Review Committee has been authorized to assist the General Assembly in reviewing the sales tax exemptions. The committee must make a detailed and careful study of the exemptions, comparing South Carolina laws to other states; publish a comparison of the exemptions to other states' laws; recommend changes, recommend the introduction of legislation when appropriate; and submit reports and recommendations annually to the Governor and the General Assembly regarding the exemptions.

Statutory Changes Needed for South Carolina to Comply

All product-based exemptions (exemptions based on the description of the product and not based on who purchases the product or how the purchaser intends to use the product) must comply with various provisions in the Agreement.

For example, an exemption for an item defined in the Agreement must use or be consistent with the definition in the Agreement. The exemptions in Code Section 12-36-2120 that would be affected by the Agreement's definitions, or that would need to be modified as a result of the Agreement, include:

12-36-2120(10) – exemptions for certain meals and food provided at schools, to the elderly and to the needy

12-36-2120(11) – exemptions for several types of telecommunications charges

12-36-2120(28) – exemptions for certain medicines, prosthetic devices, and other medical supplies

12-36-2120(38) – exemption for hearing aids

12-36-2120(54) – exemption for clothing required for a Class 100 or better clean room

12-36-2120(57) – sales tax holiday exemption (See Section A.4. concerning the Agreement's sale tax holiday provisions.)

12-36-2120(58) – exemption for certain “direct mail” promotional items

12-36-2120(63) - exemptions for certain medicines, prosthetic devices, and other medical supplies

12-36-2120(65) – exemption for computer equipment at technology intensive facility

12-36-2120(74) – exemption for durable medical equipment⁴⁵

The requirement to use the Agreement’s product definition will most likely affect revenue. As such, the General Assembly will need to decide for each affected exemption one of the following options:

- Continue to exempt the product using the required definition and accept the gain or loss in revenue as applicable;
- Continue to exempt the product using the required definition, but, to the extent possible, reword the exemption in a manner that will offset increases in revenue as a result of the definition or that will offset revenue loss as a result of the definition, whichever is applicable;
- Adopt some or all of the optional restrictions, if any, allowed in a definition so as to reduce any possible revenue loss; or,
- Eliminate the exemption to reduce any possible revenue loss.

For example, the Agreement definition of a prosthetic device is much broader than the definition currently used in South Carolina. South Carolina only exempts prosthetic devices that replace a missing part of the body. The Agreement definition of prosthetic devices exempts devices that not only replace a missing part of the body, but also prevent or correct a physical deformity or malfunction or that supports a weak or deformed portion of the body.

While under the Agreement a state may exclude corrective eyeglasses, contacts, hearing aids, and dental prosthesis from the definition of prosthetic devices, the Agreement definition is much more expansive than the present South Carolina definition. The

⁴⁵ Presently, sales of certain durable medical equipment are taxed at a rate of 5.5%; however, the exemption will be phased-in over several years by gradually lowering the tax rate. Beginning with the February 15, 2008 forecast by the Board of Economic Advisors (“BEA”) of annual general fund revenue growth for the upcoming fiscal year, and annually thereafter, if the forecast of that growth equals at least five percent of the most recent estimate by the board of general fund revenues for the current fiscal year, then the applicable state sales and use tax rate imposed on durable medical equipment is reduced, effective the following July first, by one and one-half percent in the first year and by one percent every year thereafter. That reduced rate applies until a subsequent reduction takes effect. If the February fifteenth forecast meets the requirement for a rate reduction, the BEA must certify the result in writing to the Department. On the July first that the rate attains zero, the sale of durable medical equipment will be exempt from both state and local sales and use taxes.

following are examples of items not presently exempt in South Carolina, but that would be exempt under the Agreement's definition of prosthetic devices:⁴⁶

- abdominal belts or binders
- back braces
- braces
- cervical collar
- arch supports
- hearing aid batteries
- heel protectors
- pacemakers
- splints

The Agreement also allows states to limit the exemption for prosthetic devices by requiring a "prescription" as defined in the Agreement or by basing the exemption on Medicare or Medicaid payments or reimbursements.

4. Sales tax holidays

Agreement Requirement

A temporary sales tax exemption for certain products for a specific period of time is generally referred to as a "sales tax holiday." The Agreement allows for sales tax holidays, but establishes certain restrictions with respect to such exemptions. Section 322 of the Agreement states, in part:

- A. If a member state allows for temporary exemption periods, commonly referred to as sales tax holidays, the member state shall:
 - 1. Not apply an exemption unless the items to be exempted are specifically defined in the Agreement and the exemptions

⁴⁶ As discussed in footnote #45, sales of certain durable medical equipment are presently taxed at a rate of 5.5%; however, the exemption will be phased-in over several years by gradually lowering the tax rate. Some items in this list of examples of "prosthetic devices" under the Agreement's definition may qualify as durable medical equipment under the present South Carolina law that became effective July 1, 2007. This "phased-in" exemption only applies to exemption for durable medical equipment and related supplies as defined under federal and state Medicaid and Medicare laws. In order for the purchase of the durable medical equipment and related supplies to be exempt, the following conditions must be met: (1) the purchase must be paid directly by funds of South Carolina or the United States under the Medicaid or Medicare programs; (2) state or federal law or regulation authorizing the payment must prohibit the payment of the sale or use tax; and (3) the durable medical equipment and related supplies must be sold by a provider who holds a South Carolina retail sales license and whose principal place of business is located in South Carolina.

are uniformly applied to state and local sales and use taxes.

2. Provide notice of the exemption period at least sixty days' prior to the first day of the calendar quarter in which the exemption period will begin.

B. A member state may establish a sales tax holiday that utilizes price thresholds set by such state and the provisions of the Agreement on the use of thresholds shall not apply to exemptions provided by a state during a sales tax holiday.

Section 322 also establishes specific administrative procedures that a member state must comply with during a sales tax holiday. These provisions concern:

- layaway sales
- bundled sales
- coupons and discounts
- splitting of items normally sold together
- rain checks
- exchanges
- delivery charges
- order dates and back orders
- returns
- time zones

The Agreement also establishes several definitions that apply only to sales tax holidays.

- eligible property
- layaway sale
- rain check
- school supply
- school art supply
- school instructional material
- school computer supply

To summarize, the Agreement sets forth the following requirements with respect to any sales tax holiday enacted in a member state:

- A sales tax holiday exemption is only allowed for a product specifically defined in the Agreement. While the above product definitions and administrative terms only apply to sales tax holiday exemption, any product defined in the Agreement may be exempt during the sales tax holiday. If a

product is not defined in the Agreement, it cannot be exempt under a sales tax holiday exemption.

- A notice as to the sales tax holiday must be provided at least sixty days prior to the first day of the calendar quarter in which the holiday will begin.
- A state may use price thresholds for sales tax holiday exemption purposes.

Current South Carolina Law

South Carolina has established a permanent sales tax holiday that begins at 12:01 am on the first Friday of each August and lasts for three days ending at twelve midnight on the following Sunday.

Code Section 12-36-2120(57) establishes the sales tax holiday exemption, and reads:

(a) sales taking place during a period beginning 12:01 a.m. on the first Friday in August and ending at twelve midnight the following Sunday of:

- (i) clothing;
- (ii) clothing accessories including, but not limited to, hats, scarves, hosiery, and handbags;
- (iii) footwear;
- (iv) school supplies including, but not limited to, pens, pencils, paper, binders, notebooks, books, bookbags, lunchboxes, and calculators;
- (v) computers, printers and printer supplies, and computer software;
- (vi) bath wash clothes, blankets, bed spreads, bed linens, sheet sets, comforter sets, bath towels, shower curtains, bath rugs and mats, pillows, and pillow cases.

(b) The exemption allowed by this item does not apply to:

- (i) sales of jewelry, cosmetics, eyewear, wallets, watches;
- (ii) sales of furniture;
- (iii) a sale of an item placed on layaway or similar deferred payment and delivery plan however described;
- (iv) rental of clothing or footwear;
- (v) a sale or lease of an item for use in a trade or business.

(c) Before July tenth of each year, the department shall publish and make available to the public and retailers a list of those articles qualifying for the exemption allowed by this item.

For a detailed list of items exempt and not exempt during South Carolina's sales tax holiday, see SC Revenue Ruling #05-9 which is attached as Exhibit "J."

Statutory Changes Needed for South Carolina to Comply

The Agreement would require South Carolina to amend its sales tax holiday exemption to comply with the Agreement requirement that only items defined in the Agreement can be exempt under a sales tax holiday exemption and to ensure South Carolina's definitions comply with the Agreement.

In order to comply with the Agreement, South Carolina would need to amend the sales tax holiday exemption to repeal that part of the exemption for the following items not defined in the Agreement:

bath wash clothes, blankets, bed spreads, bed linens, sheet sets, comforter sets, bath towels, shower curtains, bath rugs and mats, pillows, and pillow cases; and

printers and printer supplies.

In addition, South Carolina would need to adopt the Agreement definitions for "school supplies." This would eliminate some items currently exempt as "school supplies." For example, musical instruments would no longer qualify for the sales tax holiday exemption.

Finally, adoption of the Agreement would eliminate the possibility of having a another "sales tax holiday" that only applies to the state tax and not local taxes as occurred this past November 2006 since the Agreement requires all "sales tax holidays" to apply to both state and local sales taxes.

5. Tax Matrix

Agreement Requirement

The Agreement requires each state to complete a "taxability matrix." The taxability matrix summarizes whether a product which is defined by the Agreement is taxed or exempt under a state's sales and use tax law. For example, the taxability index would list the application of the tax or an exemption with respect to such items as clothing, food, prepared food, candy, soft drinks, durable medical equipment, and computer software.

If a seller or Certified Service Provider relies on the matrix, the seller or Certified Service Provider is relieved from liability for incorrectly collecting tax as a result of erroneous information provided in the matrix by the state.

Section 328 of the Agreement sets forth the requirements for the taxability matrix, and states:

- A. To ensure uniform application of terms defined in the Library of Definitions each member state shall complete a taxability matrix adopted by the governing board. The member state's entries in the matrix shall be provided and maintained in a database that is in a downloadable format approved by the governing board. A member state shall provide notice of changes in the taxability of the products or services listed in the taxability matrix as required by the governing board.
- B. A member state shall relieve sellers and CSPs from liability to the member state and its local jurisdictions for having charged and collected the incorrect amount of sales or use tax resulting from the seller or CSP relying on erroneous data provided by the member state in the taxability

The matrix completed by a state must be made available in downloadable form and states must provide notice of changes in the matrix. In addition, a matrix does not provide information as to all goods and services. Finally, while a seller who relies on the matrix and fails to collect the tax is relieved of liability, a state may still seek to collect any use tax due from the purchaser.

The taxability matrix that must be used by a state is attached as Exhibit "C."

Current South Carolina Law

South Carolina does not publish any type of matrix similar to the one required in the Agreement. However, the South Carolina Department of Revenue does issue and publish advisory opinions on various issues, publishes other information on its website (www.sctax.org), and conducts taxpayer education seminars.

For example, the Department has issued the following advisory opinions:⁴⁷

SC Revenue Ruling #03-2 - The South Carolina sales and use tax statute exempts the retail sale of certain medicines, prosthetic devices and medical supplies. The purpose of this advisory opinion is to provide guidance as to the

⁴⁷ A revenue ruling is issued to provide guidance to the public and Department personnel and applies principles of tax law to a specific set of facts or a general category of taxpayers. It does not have the force and effect of law. It is, however, the Department's position and is binding on agency personnel and therefore can be relied upon by the public until superseded or modified by a change in statute, regulation, court decision or advisory opinion.

application of these exemptions with respect to sales of these items to individuals, doctors, clinics and hospitals and similar facilities.

SC Revenue Ruling #05-9 – This advisory opinion provides examples of items exempt and non-exempt under South Carolina’s sales tax holiday.

SC Revenue Ruling #05-10 – This advisory opinion provides answers to various administrative questions concerning South Carolina’s sales tax holiday.

SC Revenue Ruling #06-5 – This advisory opinion provides guidance as to the type of foods subject to the new lower (3%) sales and use tax rate for unprepared food.

SC Revenue Ruling #06-8 – This advisory opinion “summarizes” longstanding Department opinion concerning the taxability of various communication services and attempts to list as many communication services as possible that the Department has held in the past as subject to the tax, whether through formal advisory opinions, audits or informal advice provided to taxpayers.

The following provides examples of sales and use tax seminars the Department has conducted for taxpayers in recent years:

- Healthcare Issues
- Educational Issues
- Retail
- Manufacturing
- Accommodations

In these seminars, Department employees discuss (1) the basics of sales & use tax law, (2) an update of new sales & use tax law, (3) information on exemptions, exclusions & certificates, (4) information about business personal property taxes, (5) the latest on local option sales tax, (6) what to expect if you're audited, (7) electronic services for businesses, and (8) filing & administrative requirements.

While South Carolina does not relieve taxpayers of liability for the tax if the taxpayer relied on erroneous information from an employee, the South Carolina Taxpayer Bill of Rights provides relief from penalties and interest if certain conditions are met. Specifically, Code Section 12-58-100 of the *South Carolina Taxpayers’ Bill of Rights* states:

(A) If the department finds that a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from the department, the person is relieved of any penalty or interest, notwithstanding the provisions of Section 12-54-160.

(B) For the purposes of this section, a person's failure to make a timely return or payment is considered to be due to reasonable reliance on written advice from the department only if the department finds that all of the following conditions are satisfied:

(1) The person requested in writing that the department advise him whether a particular activity or transaction is subject to tax under the tax laws administered by the department, and the specific facts and circumstances of the activity or transaction were fully described in the request.

(2) The department responded in writing to the person regarding the written request for advice, stating whether or not the described activity or transaction is subject to tax, or stating the conditions under which the activity or transaction is subject to tax.

(3) In reasonable reliance on the department's written advice, the person did not remit the tax due.

(4) The liability for taxes applied to a particular activity or transaction which occurred before either of the following:

(a) the department rescinded or modified the advice so given by sending written notice to the person of the rescinded or modified advice;

(b) a change in statutory or constitutional law, a change in the department's regulations, or a final decision of a court, which rendered the department's earlier written advice no longer valid;

(c) any person seeking relief under this section shall file with the department all of the following:

(i) a copy of the person's written request to the department and a copy of the department's written advice;

(ii) a statement signed under penalty of perjury, setting forth the facts on which the claim is based;

(iii) any other information which the department may require.

(d) only the person making the written request may rely on the department's written advice to that person.

Statutory Changes Needed for South Carolina to Comply

By itself, completing the taxability matrix does not require any changes in South Carolina sales and use tax law. However, South Carolina must of course comply with all provisions of the Agreement and must amend its law to do so before it can complete the taxability matrix.

B. Tax Rates

1. Single Rate

Agreement Requirement

The Agreement requires a state to maintain only one general state sales and use tax rate, except that another rate is allowed for food and food ingredients and drugs. Each local jurisdiction must also maintain only one local sales and use tax rate. These requirements do not apply to certain utility services, motor vehicles, aircraft, watercraft, modular homes, manufactured homes, or mobile homes.

Section 308 of the Agreement establishes these requirements, and reads:

- A. No member state shall have multiple state sales and use tax rates on items of personal property or services after December 31, 2005, except that a member state may impose a single additional rate, which may be zero, on food and food ingredients and drugs as defined by state law pursuant to the Agreement.
- B. A member state that has local jurisdictions that levy a sales or use tax shall not have more than one local sales tax rate or more than one local use tax rate per local jurisdiction. If the local jurisdiction levies both a sales tax and use tax, the local rates must be identical.
- C. The provisions of this section do not apply to sales or use taxes levied on electricity, piped natural or artificial gas, or other heating fuels delivered by the seller, or the retail sale or transfer of motor vehicles, aircraft, watercraft, modular homes, manufactured homes, or mobile homes.

The additional rate for food and food ingredients and drugs may be zero. This essentially allows a state to exempt food and drugs from the state tax while still taxing these items under the local sales and use tax.

In discussing the issue, *Hellerstein and Swain* state:

The purpose of the exception for food and drugs is to allow states to preserve existing two-rate schemes for these politically sensitive items, and further, by the application of a zero rate, to allow a de facto exemption at the state level for food and drugs while including food and drugs in the local tax base. This allows some states to preserve their current pattern of exempting food or drugs at the state level while taxing them at the local level. The use of “and” rather than “or” in the food/drug rate exception suggests that the allowable single additional rate must be applied to both food and drugs. The [Agreement] records indicate, however, that the adoption of the single additional rate option was in large part a concession to Illinois, which exempts food but taxes drugs. Accordingly, it is probable that the Governing Board will interpret the additional rate exemption to apply to “food and food ingredients” and/or “drugs.”

Current South Carolina Law

South Carolina imposes the following state tax rates under the sales and use tax law authorized in Chapter 36 of Title 12:

General Sales and Use Tax Rate:	6%
Accommodations Tax Rate:	7%
900 and 976 Tax Rate:	11%
Manufactured Home Maximum Tax Items ⁴⁹	5% + 2% for amounts over \$6,000 ⁴⁸ 5% (Maximum Tax: \$300.00)
Unprepared Food	3% ⁵⁰
Sales to Persons 85 and Older	5%
Certain Construction Material	4% ⁵¹
Durable Medical Equipment ⁵²	5.5% ⁵³

⁴⁸ The 5% tax is capped at \$300 under the maximum tax provisions of Code Section 12-36-2110 and the 2% tax on amounts over \$6,000 only applies if the home does not meet certain energy efficient standards.

⁴⁹ The maximum tax applies to aircraft (including unassembled aircraft which is to be assembled by the purchaser), motor vehicles, motorcycles, boats, trailers and semitrailers that can only be pulled by a truck tractor, horse trailers, fire safety education trailers, recreational vehicles (including tent campers, travel trailers, park models, park trailers, motor homes, and fifth wheels), self-propelled light constructions equipment limited to a maximum 160 net engine horsepower, manufactured homes, and certain musical instruments and office equipment sold to religious organizations exempt under IRC Section 501(c)(3).

⁵⁰ On and after November 1, 2007, unprepared food will be exempt from the state sales and use tax, but not local sales and use taxes unless the specific local sales and use tax exempts such food.

⁵¹ Effective July 1, 2011, Code Section 12-36-2120(67) exempts construction materials used in the construction of a single manufacturing and distribution facility with a capital investment of at least \$100 million in real and personal property in the State over an 18 month period. However, the exemption will be phased in over several years. Beginning July 1, 2007 the tax rate is 4%. Each July 1st after that the tax rate is reduce by another 1% until such sales are fully exempt beginning July 1, 2011.

⁵² The lower rate also applies to related supplies.

In addition, the sales tax due on the sale in South Carolina to a nonresident of a motor vehicle, trailer, semitrailer, or pole trailer that is to be registered and licensed in the nonresident purchaser's state of residence is the lesser of (a) the sales tax which would be imposed on the sale in the purchaser's state of residence or (b) the tax that would be imposed under Chapter 36 of the South Carolina Code of Laws. No sales tax is due in South Carolina if a nonresident purchaser cannot receive a credit in his resident state for sales tax paid to South Carolina. See SC Information Letter #05-13 attached as Exhibit "K."

The South Carolina Code of Laws also allows the imposition of various types of local sales and use taxes. As such, a county may impose one or several local sales and use taxes. SC Information Letter #07-4, which was issued by the Department of Revenue and is attached as Exhibit "I," provides guidance concerning the various types of local sales and use taxes presently collected by the Department of Revenue. This information letter only addresses the general local sales and use taxes collected by the Department of Revenue on behalf of the counties, school districts, and the Catawba Indian tribal government. It does not address the local taxes on sales of accommodations or on sales of prepared meals that are collected directly by the counties. Most counties presently only impose one local sales and use tax at the rate of 1%; however, several counties do impose two local sales and use taxes at the total rate of either 1.5% or 2%.

Statutory Changes Needed for South Carolina to Comply

The Agreement would require South Carolina to amend its state sales and use tax to establish only one state rate. This requirement does not apply to food, electricity, piped natural or artificial gas, other heating fuels delivered by the seller, motor vehicles, aircraft, watercraft, modular homes and manufactured homes.

The following changes must be made in order to establish a single state tax rate (with exceptions noted above) in South Carolina:

- An amendment to the state law to do one of the following: (1) lower the 7% state tax rate for the sales tax on accommodation to 6%, (2) raise the 6% state tax rate on all other items and services to 7%, or (3) repeal the 7% sales tax on accommodations and create a new separate 7% "lodging" tax. A separate "lodging" tax would likely require hotels and others providing sleeping

⁵³ Beginning with the February 15, 2008 forecast by the Board of Economic Advisors ("BEA") of annual general fund revenue growth for the upcoming fiscal year, and annually thereafter, if the forecast of that growth equals at least five percent of the most recent estimate by the BEA of general fund revenues for the current fiscal year, then the applicable state sales and use tax rate imposed on durable medical equipment is reduced, effective the following July first, by one and one-half percent in the first year and by one percent every year thereafter. That reduced rate applies until a subsequent reduction takes effect. If the February fifteenth forecast meets the requirement for a rate reduction, the BEA must certify the result in writing to the Department. On the July first that the rate attains zero, the sale of durable medical equipment will be exempt from both state and local sales and use taxes.

accommodations to file several returns – a sales tax return, a lodging tax return, and possibly a local accommodations tax return. (Note: A separate lodging tax appears to be the norm among the states since taxes on accommodations are typically imposed at a higher rate than the general sales and use tax rate.) See the discussion of “Replacement Taxes” in Section XII – Current Issues.

- An amendment to the state law to do one of the following: (1) lower the 11% rate on 900 and 976 telephone numbers to 6%, (2) repeal the 11% tax on 900 and 976 telephone numbers, or (3) repeal the 11% tax on 900 and 976 telephone numbers and create a new separate 11% “900 and 976 service” tax. A separate “900 and 976 service” tax would require some communications companies providing 900 and 976 telephone services as well as other communications services (“ways or means for the transmission of the voice or messages”) to file a sales tax return for communication services and a “900 and 976 service” return.
- An amendment to the state law so that sales of trailers and semitrailers to nonresidents would no longer be taxed at the rate charged in the purchaser’s state of residence. Such sales must be taxed at the South Carolina rate. (The exception in the Agreement for motor vehicles would not require this change for motor vehicles.)
- An amendment to state law so that sales to persons eighty-five years of age and older are taxed at the full tax rate or are completely exempt. Presently, sales to persons eighty-five years and older are taxed a rate 1% less than the full tax rate.

Note: As part of any change in which a lower rate is implemented, South Carolina could also raise the state tax rate on one of the exceptions for electricity, piped natural or artificial gas, other heating fuels delivered by the seller, motor vehicles, aircraft, watercraft, modular homes and manufactured homes in order to maintain revenues.

The Agreement requires that each local jurisdiction (e.g., a county, municipality) have only one rate. In other words, a county could not have sales in part of the county taxed at 6% and sales in the remainder of the county taxed at 7%.

The following changes must be made in order to establish one local sales and use tax rate for each local jurisdiction (with exceptions noted above) in South Carolina:

- At present, approximately 15 municipalities are located in more than one county. This could be a problem since it is possible anyone of these municipalities presently, or in the future, could have more than one local tax rate if one county in which the municipality is located imposes a higher rate

than the other county. In addition, one local tax, the local option sales and use tax, requires the seller to report all sales by municipality as well as by county.

However, since a municipality may not presently impose a local sales and use tax, the issue arises as to whether the municipality would constitute a local taxing jurisdiction for purposes of the Agreement. Such an issue would have to be researched and possibly reviewed by the Governing Board.

- The tax rate for the Catawba Tribal Tax is based on the total state and local sales and use tax rates for the counties in which the reservation is located. Presently, both counties, York and Lancaster, impose a total state and local rate of 7%. This could also be a problem if the Catawba Indian Reservation is considered a local jurisdiction for purposes of the Agreement since it is possible for the reservation to have two tax rates under the Catawba Indian Settlement agreement.

However, since the Catawba Indian Tribal Reservation may be considered a sovereign nation and not a local taxing jurisdiction, the possibility of different tax rates on the reservation may not be an issue.

2. Caps and thresholds

Agreement Requirement

Caps are limits on the rate that can be applied in calculating the tax due or are limits on the dollar amount of tax that can be applied to a purchase. Thresholds are typically limits placed on an exemption.

Section 323 of the Agreement limits the use of caps and thresholds, and states in part:

- A. Each member state shall:
 1. Not have caps or thresholds on the application of state sales or use tax rates or exemptions that are based on the value of the transaction or item
 2. Not have caps that are based on the application of the rates unless the member state assumes the administrative responsibility in a manner that places no additional burden on the retailer.
- B. Each member state that has local jurisdictions that levy a sales or use tax shall not place caps or thresholds on the application of local rates or use tax rates or exemptions that are based on the value of the transaction or item.

- C. The provisions of this section do not apply to sales or use taxes levied on the retail sale or transfer of motor vehicles, aircraft, watercraft, modular homes, manufactured homes, or mobile homes or to instances where the burden of administration has been shifted from the retailer.

Current South Carolina Law

South Carolina's sales and use tax law authorizes several maximum tax caps. These caps can be found in Code Section 12-36-2110, which states:

(A) The maximum tax imposed by this chapter is three hundred dollars for each sale made after June 30, 1984, or lease executed after August 31, 1985, of each:

- (1) aircraft, including unassembled aircraft which is to be assembled by the purchaser, but not items to be added to the unassembled aircraft;
- (2) motor vehicle;
- (3) motorcycle;
- (4) boat;
- (5) trailer or semitrailer, pulled by a truck tractor, as defined in Section 56-3-20, and horse trailers, but not including house trailers or campers as defined in Section 56-3-710 or a fire safety education trailer;
- (6) recreational vehicle, including tent campers, travel trailer, park model, park trailer, motor home, and fifth wheel; or
- (7) self-propelled light construction equipment with compatible attachments limited to a maximum of one hundred sixty net engine horsepower.

In the case of a lease, the total tax rate required by law applies on each payment until the total tax paid equals three hundred dollars. Nothing in this section prohibits a taxpayer from paying the total tax due at the time of execution of the lease, or with any payment under the lease. To qualify for the tax limitation provided by this section, a lease must be in writing and specifically state the term of, and remain in force for, a period in excess of ninety continuous days.

(B) For the sale of a manufactured home, as defined in Section 40-29-20, the tax is calculated as follows:

- (1) subtract trade-in allowance from the sales price;
- (2) multiply the result from (1) by sixty-five percent;
- (3) if the result from (2) is no greater than six thousand dollars, multiply by five percent for the amount of tax due;
- (4) if the result from (2) is greater than six thousand dollars, the tax due is three hundred dollars plus two percent of the amount greater than six thousand dollars.

However, a manufactured home is exempt from any tax that may be due above three hundred dollars as a result of the calculation in item (4) if it meets these energy efficiency levels: storm or double pane glass windows, insulated or storm doors, a minimum thermal resistance rating of the insulation only of R-11 for walls, R-19 for floors, and R-30 for ceilings. However, variations in the energy efficiency levels for walls, floors, and ceilings are allowed and the exemption on tax due above three hundred dollars applies if the total heat loss does not exceed that calculated using the levels of R-11 for walls, R-19 for floors, and R-30 for ceilings. The edition of the American Society of Heating, Refrigerating, and Air Conditioning Engineers Guide in effect at the time is the source for heat loss calculation. The dealer selling the manufactured home must maintain records, on forms provided by the State Energy Office, on each manufactured home sold which contains the above calculations and verifying whether or not the manufactured home met the energy efficiency levels provided for in this subsection. These records must be maintained for three years and must be made available for inspection upon request of the Department of Consumer Affairs or the State Energy Office.

The maximum tax authorized by this subsection does not apply to a single-family modular home regulated pursuant to Chapter 43, Title 23.

(C) For the sale of each musical instrument, or each piece of office equipment, purchased by a religious organization exempt under Internal Revenue Code Section 501(c)(3), the maximum tax imposed by this chapter is three hundred dollars. The musical instrument or office equipment must be located on church property and used exclusively for the organizations exempt purpose. The religious organization must furnish to the seller an affidavit on forms prescribed by the department. The affidavit must be retained by the seller.

(D) Repealed.

(E) Equipment provided, supplied, or installed on a firefighting vehicle is included with the vehicle for purposes of calculating the maximum tax due under this section.

Code Section 12-36-2120(67) exempts “construction materials used in the construction of a single manufacturing and distribution facility with a capital investment of at least one hundred million in real and personal property in the State over an eighteen-month period.” While this exemption is not fully effective until July 1, 2011, it does provide a temporary tax rate cap as it is phased-in as follows:

4% for sales from July 1, 2007 through June 30, 2008

3% for sales from July 1, 2008 through June 30, 2009

2% for sales from July 1, 2009 through June 30, 2010

1% for sales from July 1, 2010 through June 30, 2011

Code Section 12-36-2120 was amended during the 2007 session of the General Assembly to add an exemption for durable medical equipment and related supplies as defined under federal and state Medicaid and Medicare laws. In order for the purchase of the durable medical equipment and related supplies to be exempt, the (1) the purchase must be paid directly by funds of South Carolina or the United States under the Medicaid or Medicare programs, (2) State or federal law or regulation authorizing the payment must prohibit the payment of the sale or use tax, and (3) the durable medical equipment and related supplies must be sold by a provider who holds a South Carolina retail sales license and whose principal place of business is located in South Carolina.

The exemption will be phased in by reducing the rate of taxation as follows:

5.5% for sales from July 1, 2007, through June 30, 2008,

4% for such sales occurring during the next State fiscal year (July 1 through June 30) following the February 15th forecast by the Board of Economic Advisors (“BEA”) of annual general fund growth for the upcoming State fiscal year for which the forecast of growth equals at least five percent of the most recent estimate by the BEA of general fund revenues for the current State fiscal year,

3% for such sales occurring during the next State fiscal year following the February 15th forecast by the BEA of annual general fund growth meeting the five percent growth requirement for the next fiscal year as discussed above,

2% for such sales occurring during the next State fiscal year following the February 15th forecast by the BEA of annual general fund growth meeting the five percent growth requirement for the next fiscal year as discussed above,

1% for such sales occurring during the next State fiscal year following the February 15th forecast by the BEA of annual general fund growth meeting the five percent growth requirement for the next fiscal year as discussed above.

Sales on or after July 1st of the next State fiscal year following the February 15th forecast by the BEA of annual general fund growth meeting the five percent growth requirement for the next fiscal year as discussed above will be exempt.

Two other non-exemption provisions provide tax rate caps.

Code Sections 12-36-2620 and 12-36-2630 essentially provide a tax rate cap by imposing the sales and use tax on sales to individuals 85 years of age or older (when certain conditions are met) at a rate 1% less than the rate charged on sales to all other persons.

Code Section 12-36-920 also provides a tax rate cap by imposing the sales tax on sales of motor vehicles, trailers, semitrailers and pole trailers to nonresidents at the rate charged such nonresidents in their state of residence. In some case the rate will be equal to or greater than the South Carolina rate, but in those cases where the rate is less than the rate charged in South Carolina a type of tax rate cap has been imposed.

South Carolina's sales and use tax law also authorizes several threshold provisions. The exemptions provisions of Code Section 12-36-2120 provide the following thresholds:

(34) fifty percent of the gross proceeds of the sale of a modular home regulated pursuant to Chapter 43 of Title 23, both on-frame and off-frame.

(62) seventy percent of the gross proceeds of the rental or lease of portable toilets.

Finally, as stated in the Agreement, the prohibition against caps and thresholds does not apply to sales or use taxes levied on the retail sale or transfer of motor vehicles, aircraft, watercraft, modular homes, manufactured homes, or mobile homes or to instances where the burden of administration has been shifted from the retailer.

Statutory Changes Needed for South Carolina to Comply

In order to comply with the Agreement's provisions concerning caps and threshold, the General Assembly would need to make the following changes to the law:

- An amendment of the \$300 maximum tax provisions to either eliminate the maximum tax for, or to completely exempt from the tax, the following items:
 - (1) unassembled aircraft,
 - (2) trailers and semitrailers pulled by a truck tractor,

- (3) horse trailers,
- (4) non-motorized recreational vehicles, such as tent campers, travel trailers, park models, park trailers, and fifth wheels, and
- (5) musical instruments and office equipment sold to religious organizations.

The General Assembly may be able to exempt these and other maximum tax items by exempting them from the sales and use tax and imposing a new replacement tax on such items. See the discussion of “Replacement Taxes” in Section XII – Current Issues.

- An amendment to the fifty percent exemption for sale of a modular home and the seventy percent exemption for the rental or lease of portable toilets to fully tax such transactions or to fully exempt such transactions. Or, with respect to modular homes, the General Assembly could tax the purchase, or the cost of, the material incorporated into the modular home.
- An amendment to fully tax or to fully exempt immediately “construction materials used in the construction of a single manufacturing and distribution facility with a capital investment of at least one hundred million in real and personal property in the State over an eighteen-month period” – if the exemption is not fully implemented when (and if) the Agreement is adopted in South Carolina.
- An amendment to fully tax or to fully exempt immediately “durable medical equipment” if the exemption is not fully implemented when (and if) the Agreement is adopted in South Carolina.⁵⁴

3. Changing Tax Rates

Agreement Requirement

Sellers operating in multiple taxing jurisdictions must keep track of the state and local tax rates in each jurisdiction where they make sales and have nexus.⁵⁵ For a large seller operating nationwide, this could mean tracking state and local rates in over 7,500 taxing jurisdictions.

⁵⁴ As discussed in the section concerning “Definitions,” the definition for “durable medical equipment” would need to be amended to adopt the definition found in the Agreement if the decision is made to fully exempt such items.

⁵⁵ Nexus is a sufficient connection between a person and a state, and a sufficient connection between an activity, property, or transaction and a state, that allows the state to subject the person, and the activity, property, or transaction to its taxing jurisdiction. The Due Process and Commerce Clauses of the United States Constitution and other federal statutes provide limitations on a state’s powers to tax out of state businesses.

Sellers are only required to collect and remit the tax in states in which they have nexus. However, under the Agreement sellers volunteer to collect tax in all member states—including states in which they do not have a nexus.

The Agreement requires local tax rate changes to occur on the first day of a calendar quarter and strongly encourages state tax rate changes to occur on the first day of a calendar quarter as well. Local tax rate changes require a minimum of 60 days notice. The notice requirement is extended to 120 days for retailers selling via printed catalogs.

Section 304 of the Agreement states, in part:

Each member state shall lessen the difficulties faced by sellers when there is a change in a state sales or use tax rate or base by making a reasonable effort to do all of the following:

1. Provide sellers with as much advance notice as practicable of a rate change.
2. Limit the effective date of a rate change to the first day of a calendar quarter.
3. Notify sellers of legislative changes in the tax base and amendments to sales and use tax rules and regulations.

Section 305 of the Agreement requires, in part:

Each member state that has local jurisdictions that levy a sales or use tax shall:

- A. Provide that local rate changes will be effective only on the first day of a calendar quarter after a minimum of sixty days' notice to sellers.
- B. Apply local sales tax rate changes to purchases from printed catalogs wherein the purchaser computed the tax based upon local tax rates published in the catalog only on the first day of a calendar quarter after a minimum of one hundred twenty days' notice to sellers
- C. For sales and use tax purposes only, apply local jurisdiction boundary changes only on the first day of a calendar quarter after a minimum of sixty days' notice to sellers.

Section 329 of the Agreement establishes transitional rules for service contracts that cover a period which overlaps the effective date of a tax rate change, and states:

Each member state shall provide that the effective date of rate changes for services covering a period starting before and ending after the statutory effective date shall be as follows:

- A. For a rate increase, the new rate shall apply to the first billing period starting on or after the effective date.
- B. For a rate decrease, the new rate shall apply to bills rendered on or after the effective date.

Current South Carolina Law

The effective date for changes in the state sales and use tax rate are established by the General Assembly.

For example, the most recent change in the state rate change became effective on June 1, 2007. This would have been permissible but discouraged under the Agreement. The Agreement strongly encourages such a change in the state rate to take place on January 1st, April 1st, July 1st, or October 1st.

The effective date for changes in local sales and use tax rates varies depending on the type of local tax being imposed. A review of the chart in Exhibit "I" indicates that since the authorization of local sales and use taxes began in 1991 the effective dates have occurred on February 1st, March 1st, April 1st, May 1st, June 1st, July 1st, September 1st, October 1st and December 1st, with May 1st being the most prevalent date. In most cases, this would not be permissible under the Agreement. The Agreement would require such changes in local rates to take place on January 1st, April 1st, July 1st, and October 1st.

Statutory Changes Needed for South Carolina to Comply

In order to comply with the Agreement's provisions concerning effective dates for changes in state and local sales and use tax rates and the rate change notification requirements, the following changes would need to be made:

- An amendment to local tax laws to establish uniform start and termination dates for new rates or new local taxes so that such taxes begin on the first day of a calendar quarter and to allow the DOR to provide retailers advanced notice (requires as much notice as practicable for a state rate change and 60 and 120 day notice in most instances for a local rate change). In the case of the termination date for local taxes that end when a certain amount of revenue has been achieved (e.g., the capital projects sales and use tax), consideration will need to be given as to how to comply with the Agreement's requirement for the uniform termination date as well as addressing the possibility of collecting a significant amount of revenue above what the public was advised was needed for the particular project or projects.

- An amendment to state tax law to make a rate change for services effective for the first billing period starting on or after the effective date (which must be the first day of a calendar quarter for local sales and use taxes).

Note: It will be important to remember with respect to tax rate changes, that enough time must be allowed for the Department to receive notification of the enactment date in the case of a state rate changes, or to receive the certification of the referendum in the case of local rate changes, to prepare a notices and issue them in sufficient time to comply with the local tax 60 or 120 day notification requirement set forth in the Agreement.

4. Rate Databases

Agreement Requirement

In order to collect and remit the proper local sales and use tax, a seller must be able to determine for each sale and shipment of a product to a customer what jurisdiction the customer is located (county, city, etc.) and what the tax rate is for that jurisdiction.

The Agreement, in an attempt to simplify and reduce the expense of determining the taxing jurisdiction and rate requires each state to develop a database assigning each 5-digit and 9-digit ZIP code in a state to a specific tax jurisdiction and rate.⁵⁶

Section 305 of the Agreement, concerning local rate and boundary changes, states in part:

Each member state that has local jurisdictions that levy a sales or use tax shall:

* * * *

- C. For sales and use tax purposes only, apply local jurisdiction boundary changes only on the first day of a calendar quarter after a minimum of sixty days' notice to sellers.
- D. Provide and maintain a database that describes boundary changes for all taxing jurisdictions. This database shall include a description of the change and the effective date of the change for sales and use tax purposes.
- E. Provide and maintain a database of all sales and use tax rates for all of the jurisdictions levying taxes within the state. For the identification of states, counties, cities, and parishes, codes corresponding to the rates must be provided according to Federal Information Processing Standards (FIPS) as developed by the National Institute of Standards and Technology. For the identification of all other jurisdictions, codes corresponding to the rates must be in the format determined by the governing board.

⁵⁶The Agreement also provides rules for sourcing the sale to a particular jurisdiction which are discussed in Section IV. C. of this report.

- F. Provide and maintain a database that assigns each five digit and nine digit zip code within a member state to the proper tax rates and jurisdictions. The state must apply the lowest combined tax rate imposed in the zip code area if the area includes more than one tax rate in any level of taxing jurisdictions. If a nine digit zip code designation is not available for a street address or if a seller or CSP is unable to determine the nine digit zip code designation applicable to a purchase after exercising due diligence to determine the designation, the seller or CSP may apply the rate for the five digit zip code area. For the purposes of this section, there is a rebuttable presumption that a seller or CSP has exercised due diligence if the seller has attempted to determine the nine digit zip code designation by utilizing software approved by the governing board that makes this designation from the street address and the five digit zip code applicable to a purchase.
- G. Have the option of providing address-based boundary database records for assigning taxing jurisdictions and their associated rates which shall be in addition to the requirements of subsection (F) of this section. The database records must be in the same approved format as the database records pursuant to subsection (F) of this section and must meet the requirements developed pursuant to the federal Mobile Telecommunications Sourcing Act (4 U.S.C.A. Sec. 119(a)). The governing board may allow a member state to require sellers that register under this Agreement to use an address-based database provided by that member state. If any member state develops address-based assignment database records pursuant to the Agreement, a seller or CSP may use those database records in place of the five and nine-digit zip code database records provided for in subsection (F) of this section. If a seller or CSP is unable to determine the applicable rate and jurisdiction using an address-based database record after exercising due diligence, the seller or CSP may apply the nine digit zip code designation applicable to a purchase. If a nine-digit zip code designation is not available for a street address or if a seller or CSP is unable to determine the nine digit zip code designation applicable to a purchase after exercising due diligence to determine the designation, the seller or CSP may apply the rate for the five digit zip code area. For the purposes of this section, there is a rebuttable presumption that a seller or CSP has exercised due diligence if the seller or CSP has attempted to determine the tax rate and jurisdiction by utilizing software approved by the governing board that makes this assignment from the address and zip code information applicable to the purchase.
- H. States that have met the requirements of subsection (F) may also elect to certify vendor provided address-based databases for

assigning tax rates and jurisdictions. The databases must be in the same approved format as the database records pursuant to (G) of this section and must meet the requirements developed pursuant to the federal Mobil Telecommunications Sourcing Act (4 U.S.C.A. Sec. 119 (a)). If a state certifies a vendor address-based database, a seller or CSP may use that database in place of the database provided for in subsection (F) or (G) of this section. Vendors providing address-based databases may request certification of their databases from the governing board. Certification by the governing board does not replace the requirement that the databases be certified by the states individually.

Section 306 of the Agreement, concerning relief from certain liability, states:

Each member state shall relieve sellers and CSPs using databases pursuant to subsections (F), (G) and (H) of Section 305 from liability to the member state and local jurisdictions for having charged and collected the incorrect amount of sales or use tax resulting from the seller or CSP relying on erroneous data provided by a member state on tax rates, boundaries, or taxing jurisdiction assignments. After providing adequate notice as determined by the governing board, a member state that provides an address-based database for assigning taxing jurisdictions pursuant to Section 305, subsection (G) or (H) may cease providing liability relief for errors resulting from the reliance on the database provided by the member state under the provisions of Section 305, subsection (F). If a seller demonstrates that requiring the use of the address-based database would create an undue hardship, a member state and the governing board may extend the relief from liability to such seller for a designated period of time.

Section 307 of the Agreement, concerning database requirements and exceptions, states:

- A. The electronic databases provided for in Section 305, subsections (D), (E), (F), and (G) shall be in a downloadable format approved by the governing board. The databases may be directly provided by the state or provided by a vendor as designated by the state. A database provided by a vendor as designated by a state shall be applicable to and subject to all provisions of Sections 305, 306 and this section. These databases must be provided at no cost to the user of the database.
- B. The provisions of Section 305, subsections (F) and (G) do not apply when the purchased product is received by the purchaser at the business location of the seller.
- C. The databases provided by Section 305, subsections (D), (E), (F), and (G) are not a requirement of a state prior to entering into the

Agreement. A seller that did not have a requirement to register in a state prior to registering pursuant to this Agreement or a CSP shall not be required to collect sales or use taxes for a state until the first day of the calendar quarter commencing more than sixty days after the state has provided the databases required by Section 305, subsections (D), (E), and (F). Provided, for the initial implementation of the Agreement pursuant to Section 701, a CSP shall be required to collect sales or use taxes for each member state, subject to the provisions of Section 705, pursuant to the terms of the operating agreement entered into between the CSP and the governing board in order to provide adequate time for testing and loading of the databases.

The Certificate of Compliance, which is attached as Exhibit “D,” summarizes the necessary requirements for member states with the following four questions.⁵⁷

- Does the state provide a database identifying rate and jurisdictional information based on 5-digit and 9-digit ZIP codes?
- Does the database provided by the state apply the lowest rate in the ZIP code if the area includes more than one tax rate?
- Does the state commit to participating with other states in development of an address-based system?⁵⁸
- Does the state relieve the seller and the Certified Service Provider⁵⁹ from liability for collecting an incorrect amount of tax by relying on data provided by the state on rates, boundaries, and jurisdiction assignments?

Current South Carolina Law

At present, local taxes imposed in South Carolina and collected by the Department are imposed countywide.⁶⁰ These local taxes address property tax reduction, capital and transportation projects, and school district funding. In counties in which a school district tax is imposed, the tax is applied countywide with the revenue either appropriated to the lone school district within the county or allocated among all the school districts within the county. One local tax, the local option sales and use tax, requires the seller to indicate the amount of sales in each municipality within the county so that revenue from the tax may be allocated among all the municipalities in the county and the county itself. While legislation has been

⁵⁷The databases provided by Section 305, subsections (D), (E), (F), and (G) (which include the ZIP code database) are not required to be available at the time a state petitions for membership. However, a seller that did not have a requirement to register in a state prior to registering pursuant to this Agreement or a CSP is not required to collect sales or use taxes for a state until the first day of the calendar quarter commencing more than sixty days after the state has provided the required databases.

⁵⁸The Agreement was amended on October 1, 2005, to replace this requirement with an option for states to provide an address-based database. The Certificate of Compliance has not been revised to reflect this amendment.

⁵⁹Certified Service Providers are agents certified under the Agreement to perform a seller’s sales tax functions.

⁶⁰Local Hospitality Taxes and Local Accommodations Taxes can be imposed by a municipality or a county and are collected directly by the municipality or county.

introduced, the General Assembly has not authorized a general local sales and use taxes that can be imposed solely within a municipality.

The Department does not have an electronic database based on 5 or 9-digit Zip Codes for local sales and use tax rates. The Department, however, does list local sales and use tax rates by Zip Codes on its website (www.sctax.org). See also Form ST-439 attached as Exhibit “N.”

Since Zip Code boundaries can cross county and municipal lines, the Department’s list of tax rates by zip codes indicates in some cases a single Zip Code in multiple counties or municipalities.

To address this issue, the Agreement requires states to assign the ZIP code to the county or municipality with the lowest tax rate. For example, the Zip Code 29001 is located in both Clarendon county and Sumter county. Clarendon’s total state and local rate is 7% and Sumter’s total state and local rate is 6%. Therefore, for any sales shipped to Zip Code 29001, the lower 6% tax rate must be applied and the sale and its associated revenue would be allocated to Sumter county even if the product was delivered into Clarendon county.

It is envisioned that the states participating in the Agreement will one day develop a downloadable database containing every street address and assigning each address with a sales tax rate. However, until that happens, the Agreement’s requirements with respect to Zip Codes may allocate revenue to the “wrong” county when a Zip Code applies to two counties with different local sales and use tax rates.

Statutory Changes Needed for South Carolina to Comply

In order to comply with the Agreement’s provisions concerning rate and Zip Code databases, the Department must develop rate and zip code databases and the statute must be amended to provide relief of liability for relying on these databases and to allow the use of the lower tax rate if the Zip Code crosses boundaries. The state may also develop and provide an addressed-based database.

C. Sourcing

Agreement Requirement

“Sourcing” is the determination of where a sale occurs. The Agreement requires a “destination based” sourcing. This essentially means that the tax is computed based on the location where the purchaser receives the property or service.

The Agreement provides general sourcing rules and several industry specific sourcing rules. Section 310 of the Agreement establishes the general sourcing rule, and states in part:

- A. The retail sale, excluding lease or rental, of a product shall be sourced as follows:
1. When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.
 2. When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller.
 3. When subsections (A)(1) and (A)(2) do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.
 4. When subsections (A)(1), (A)(2), and (A) (3) do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith.
 5. When none of the previous rules of subsections (A)(1), (A)(2), (A)(3), or (A) (4) apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which tangible personal property was shipped, from which the digital good or the computer software delivered electronically was first available for transmission by the seller, or from which the service was provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold).

The Agreement provides various industry specific sourcing rules with respect to:

- the lease or rental of tangible personal property;
- the lease or rental of motor vehicles, trailers, semitrailers, or aircraft that do not qualify as transportation equipment;
- the retail sale, including lease or rental, of transportation equipment (e.g., locomotives, railroad cars, and shipping containers);

- direct mail; and,
- telecommunications services.

In discussing the issue of “sourcing”, *Hellerstein and Swain* provides a good overview in Chapter 6 (¶ 6.01 Overview - Pages 6-2 through 6-3), and states:

[The Agreement] identifies the provision of “[u]niform sourcing rules for all taxable transactions” as one of the essential features of the streamlined system designed to “simplify and modernize sales and use tax administration.” In implementing this requirement, [the Agreement] adopts a set of “general” sourcing rules for most transactions. These rules broadly embrace the destination principle, and they apply in a hierarchical sequence depending on the circumstances surrounding the particular transaction (e.g., where the product is received) and the availability of information regarding the destination or the constructive destination of the sale (e.g., the purchaser’s address). These general provisions apply in principle “regardless of the characterization of a product as tangible personal property, a digital good, or a service. Although it may be linguistically awkward to speak about digital downloads or services as “products,” the decision to treat the sale of all products according to a single set of sourcing rules will tend to avoid disputes over the classification of a sale to achieve a particular sourcing result. In practice, however, specific sourcing rules are more likely to apply to some types of products than to others.

In addition to the general sourcing rules, [the Agreement] adopts a few individualized sourcing rules for specific industries or classes of transactions for which the general sourcing rules may not be appropriate. These include direct mail telecommunications, and leasing or rental. Finally, [the Agreement] excludes from its scope sales of certain high-ticket items that traditionally have been subject to a variety of different state rules (e.g., dollar ceilings and exemptions) and that tend not to involve cross-border trade, including the retail sale of watercraft and modular, manufactured, and mobile homes. [The Agreement] likewise excludes from its scope the retail sale (but not the lease or rental) of motor vehicles, trailers, semi-trailers, and aircraft that do not constitute “transportation equipment” (defined essentially as transportation equipment used in interstate commerce). All of the excluded items are sourced according to the requirement of each member state.

They also provide an excellent summary with respect to sourcing of leases and rentals and state in part (¶ 6.05 Lease or Rental of Tangible Personal Property – Sections 1 through 3; Pages 6-25 through 6-28),

When a lease or rental of tangible personal property, other than transportation equipment, requires recurring periodic payments, [the Agreement] sources the first such payment in accordance with the general sourcing rules described earlier but sources all subsequent payments to “the primary property location for each period covered by the payment.” The “primary property location” is the “address for the property provided by the lessee that is available to the lessor from its records maintained in the ordinary course of business, when use of this address does not constitute bad faith. [The Agreement] further provides that the “primary property location shall not be altered by the intermittent use at different locations, such as use of business property that accompanies employees on business trips and service calls.

In substance, [the Agreement] treats each lease payment as a separate sale and, except for the first such sale, which is sourced according to the general sourcing rules, sources all subsequent such sales according to a specific sourcing rule for leases or rentals of tangible personal property. ...

* * * *

When a lease or rental of tangible personal property does not require recurring periodic payments, the payment is sourced according to the general sourcing rules. ...

* * * *

[The Agreement] provides that the lease or rental of transportation equipment is to be sourced according to the general sourcing rules rather than according to the special sourcing rules applicable to leases or rentals requiring recurring periodic payments. [The Agreement] defines “transportation equipment” as locomotives and railcars used to carry persons or property in interstate commerce; specified heavy trucks, truck-tractors, and aircraft authorized to carry persons or property in interstate or foreign commerce; and containers designed for use with such locomotives and railcars, trucks and truck-tractors, and aircraft.

These sourcing rules for telecommunications are very detailed and include a multitude of definitions and can be found in Sections 314 and 315. For purposes of this report, it is merely important to note that these sourcing rules for telecommunications are modeled after the U.S. Supreme Court ruling in *Goldberg v. Sweet*, 488 US 252, 109 S. Ct. 582 (1989) and the Mobile Telecommunications Sourcing Act (4 USC Sections 116 et. seq.).

As part of complying with the Agreement’s sourcing rules, a state must also adopt a variety of sourcing definitions and must complete and certify compliance with 48

sourcing provisions in the Certificate of Compliance. For more detailed information regarding sourcing, see Sections 310 through 315 of the Agreement (Exhibit “A”).

Current South Carolina Law

The application of South Carolina’s local sales and use taxes are determined by the point of delivery or point at which title or possession, or both, is transferred by the seller to the purchaser, or the purchaser’s designee. As such, these local taxes can essentially be described as “destination” taxes. Guidelines concerning the sourcing of local sales and use taxes in South Carolina can be found in SC Revenue Ruling #91-17 and SC Revenue Ruling #05-16 – attached as Exhibit “L.”

There are some exceptions to South Carolina’s general sourcing rules. For example, specific sourcing rules for telecommunications, which are similar to the Agreement’s sourcing rules for telecommunications, can be found in Article 19 of the Sales and Use Tax law (Chapter 36 of Title 12). Another example concerns florists and can be found in SC Regulation 117-309.1.

As a “destination” state, South Carolina’s general sourcing rules are consistent with the Agreement’s general sourcing rules. The most significant difference with the present policies in South Carolina concerns the sourcing of leases. Presently, South Carolina taxes the entire lease if the original sale occurred here, regardless of where the buyer ultimately moves the property. Essentially, South Carolina looks at the entire contract as a single sale. The Agreement taxes the lease based on where the property is located at the time of each periodic payment.

Statutory Changes Needed for South Carolina to Comply

In order to comply with the Agreement’s provisions concerning sourcing, South Carolina will need to adopt the Agreement’s sourcing rules and amend various provisions of South Carolina law and regulations, including but not limited to, the telecommunications provisions of Article 19 of the sales and use tax law and how South Carolina handles leases.

D. Amnesty

Agreement Requirement

In discussing amnesty under the Agreement, it is important to remember two points – (1) a seller must have nexus (physical presence for sales and use tax purposes) with a state before the state can require that seller to collect and remit the tax on sales into the state, and (2) participation in the Streamlined project by a seller is voluntary at this time. (While participation by a seller in the Streamlined project is

voluntary, a seller with nexus with a state must still collect and remit tax to that state even if the seller does not participate in the Streamlined project.)

To entice sellers to participate, sellers that voluntarily register under the Agreement to collect tax for the member states are eligible for amnesty from uncollected or unpaid sales or use tax. States that comply with the Agreement and join the Governing Board of the project must offer amnesty for at least 12 months after joining.

Section 402 of the Agreement concerns the amnesty provisions and states:

- A Subject to the limitations in this section:
 - 1. A member state shall provide amnesty for uncollected or unpaid sales or use tax to a seller who registers to pay or to collect and remit applicable sales or use tax on sales made to purchasers in the state in accordance with the terms of the Agreement, provided that the seller was not so registered in that state in the twelve-month period preceding the effective date of the state's participation in the Agreement.
 - 2. The amnesty will preclude assessment for uncollected or unpaid sales or use tax together with penalty or interest for sales made during the period the seller was not registered in the state, provided registration occurs within twelve months of the effective date of the state's participation in the Agreement.
 - 3. Amnesty similarly shall be provided by any additional state that joins the Agreement after the seller has registered.
- B. The amnesty is not available to a seller with respect to any matter or matters for which the seller received notice of the commencement of an audit and which audit is not yet finally resolved including any related administrative and judicial processes.
- C. The amnesty is not available for sales or use taxes already paid or remitted to the state or to taxes collected by the seller.
- D. The amnesty is fully effective, absent the seller's fraud or intentional misrepresentation of a material fact, as long as the seller continues registration and continues payment or collection and remittance of applicable sales or use taxes for a period of at least thirty-six months. Each member state shall toll its statute of limitations applicable to asserting a tax liability during this thirty-six month period.

- E. The amnesty is applicable only to sales or use taxes due from a seller in its capacity as a seller and not to sales or use taxes due from a seller in its capacity as a buyer.
- F. A member state may allow amnesty on terms and conditions more favorable to a seller than the terms required by this section.

In discussing the issue of “amnesty”, *Hellerstein and Swain* (Page 7-6) states:

The amnesty extends to uncollected and unpaid sales and use taxes on the taxpayer’s sales as well as interest and penalties but is not available to taxpayers in their capacity as purchasers. Accordingly, taxpayers will remain liable for unpaid use taxes (and any applicable interest and penalties) on their purchases regardless of registration under [the Agreement]. Further, amnesty extends to taxpayers both with and without nexus. Some willful non-filers, however, may run afoul of the fraud or intentional misrepresentation requirement.

Current South Carolina Law

South Carolina does not offer amnesty; however, South Carolina does employ a Voluntary Disclosure Program as part of its Nexus/Discovery Program.

The Department’s website (www.sctax.org) describes its Voluntary Disclosure Program as follows:

Voluntary compliance is the cornerstone of our tax system. The South Carolina Department of Revenue relies on the assistance of all taxpayers in collecting and remitting the various taxes owed.

In order to further increase compliance and to foster cooperation, the Department of Revenue has developed a voluntary disclosure procedure for taxpayers who have sufficient South Carolina business activity or connection, which is called "nexus," and have not registered with the department to collect or remit South Carolina taxes. As set forth in [Revenue Procedural Bulletin 01-5](#), this voluntary disclosure program is designed to (1) encourage nonfilers to come forward voluntarily and begin paying taxes without incurring penalties and (2) allow the department to maximize compliance with limited resources. The procedure applies only in cases where nexus is the issue.

In order to attain voluntary filing status, one of the following requirements must be met:

- A. The taxpayer must register to collect or remit taxes without previous contact from the department;
- B. The taxpayer must respond timely and completely to the department's nexus questionnaire and register with the department;
or
- C. The taxpayer agrees to register if, upon review of the nexus questionnaire by a Field Services Division employee, nexus is determined to exist.

If the taxpayer qualifies as a voluntary filer, the Department of Revenue will:

- A. Accept the payment of taxes due and filing of returns for the three immediately preceding tax years, or for the number of preceding years that nexus existed, if less than three years;
- B. Apply interest in accordance with the South Carolina Code; and
- C. Waive all penalties, except in case of fraud or misrepresentation of fact.

All companies and individuals who have been conducting business in South Carolina and have not filed required tax returns in the past are encouraged to contact the department for a determination of nexus and initiation of voluntary disclosure procedures.

Statutory Changes Needed for South Carolina to Comply

If South Carolina were to adopt the Agreement and subsequently come into compliance with the Agreement, amnesty would be available for 12 months for all sellers not presently registered for collecting and remitting the sales and use tax in South Carolina. As such, prior liabilities of any seller who had nexus but was not registered with South Carolina will be lost.

E. Administrative

1. State level

Agreement Requirement

The Agreement requires state administration of state and local sales and use taxes. The specific requirement is established in Section 301 of the Agreement, which states:

Each member state shall provide state level administration of sales and use taxes. The state level administration may be performed by a member state's Tax Commission, Department of Revenue, or any other

single entity designated by state law. Sellers are only required to register with, file returns with, and remit funds to the state level authority. Each member state shall provide for collection of any local taxes and distribution of them to the appropriate taxing jurisdictions. Each member state shall conduct, or authorize others to conduct on its behalf, all audits of the sellers registered under the Agreement for that state's tax and the tax of its local jurisdictions, and local jurisdictions shall not conduct independent sales or use tax audits of sellers registered under the Agreement.

The Agreement requires the administration of state and local sales and use tax laws by a single entity. As such, sellers must only deal with that entity in registering, filing returns, and remitting state and local sales and use taxes. In addition, audits can only be conducted by that entity or someone authorized by it.

Current South Carolina Law

The Department administers and collects both the state sales and use tax and various local sales and use taxes.

SC Information Letter #07-4, which was issued by the Department of Revenue and is attached as Exhibit "I," provides guidance concerning the various types of local sales and use taxes presently collected by the Department of Revenue. This information letter only addresses the general local sales and use taxes collected by the Department of Revenue on behalf of the counties, school districts, and the Catawba Indian tribal government. It does not address the local taxes on sales of accommodations or on sales of prepared meals that are collected directly by the counties. Most counties presently only impose one local sales and use tax at the rate of 1%; however, several counties do impose two local sales and use taxes at the total rate of either 1.5% or 2%.

Statutory Changes Needed for South Carolina to Comply

The Agreement requires all state and local sales and use taxes be filed and remitted to one authority – in this case presumably the Department of Revenue. South Carolina law appears to be in compliance with this requirement; however, statutory changes may be needed to ensure that it is clear that only the Department has administrative and collection authority concerning local sales and use taxes.

Finally, local taxes on sales of accommodations ("Local Accommodations Tax") or on sales of prepared meals ("Local Hospitality Tax") are collected directly by the counties. Since many of the present member states have similar local "prepared meal" and "lodging" taxes, this may not be a problem. See also the discussion of "Replacement Taxes" in Section XII – Current Issues.

2. Online registration

Agreement Requirement

One of the Agreement's basic provisions is that a seller who registers with one member state voluntarily agrees to collect and remit sales tax with respect to sales into all member states.

Section 303 of the Agreement states, in part:

Each member state shall participate in an online sales and use tax registration system in cooperation with the other member states.⁶¹

Each member state shall participate in an online sales and use tax registration system in cooperation with the other member states. Under this system:

- A. A seller registering under the Agreement is registered in each of the member states.
- B. The member states agree not to require the payment of any registration fees or other charges for a seller to register in a state in which the seller has no legal requirement to register.
- C. A written signature from the seller is not required.
- D. An agent may register a seller under uniform procedures adopted by the member states.
- E. A seller may cancel its registration under the system at any time under uniform procedures adopted by the governing board. Cancellation does not relieve the seller of its liability for remitting to the proper states any taxes collected.

Hellerstein and Swain provides a good summary (Pages 7-3 through 7-4) and states in part:

Under [the Agreement], seller registration is voluntary. This is not to say that a seller's tax-reporting obligation is voluntary. Sellers with sufficient nexus with a state must collect and remit tax in any event. These sellers have the option, however, of either registering directly with each state with which they have nexus or registering under [the Agreement]. Registration under [the Agreement] has a different set of consequences from traditional registration. Most importantly, by registering under [the Agreement], the seller will have agreed to collect and pay tax on sales sourced to any member state, even if the seller does not have nexus with some of those

⁶¹Other related requirements are found in Sections 211, 401, 402, 403, 404, 601, 602, and 603 of the Agreement.

member states. Indeed, primary targets of [the Agreement] are remote sellers who do not have nexus with most of the states in which they have customers. [The Agreement] provides a number of inducements to voluntary registration, including one-stop, multistate electronic registration, waiver of registration fees, streamlined return and remittance procedures, relief from certain liabilities enhanced compensation for tax collection obligations, and amnesty for certain uncollected or unpaid taxes.

Member states are required to participate in [the Agreement's] online sales and use tax registration system. Seller registration under [the Agreement] constitutes registration with each member state. Registration fees may not be charged by a state if the registering seller has no legal requirement to register with the state if the registering seller has no legal requirement to register with the state. Thus, registrants without nexus in a state avoid registration fees. A written seller signature is not required, and agents may register a seller. If a seller was under an obligation to register with a state prior to registering under the Agreement but had not done so, the seller may be required to provide additional information before completing the registration process. As discussed below, registrants may be entitled to amnesty for past liabilities.

A registering seller's obligation to collect and remit taxes on all taxable sales sourced to member states extends to states joining after the seller's registration, regardless of whether the seller otherwise has nexus with the state. A seller may cancel its registration at any time. Cancellation does not, however, relieve a seller of its obligation to remit taxes collected from its customers or from any tax collection and remittance obligations that exist independently of [the Agreement] registration. Similarly, withdrawal (or expulsion) of a state from [the Agreement] does not relieve a seller of its responsibility to remit taxes collected on behalf of the state, nor does it relieve a seller of any sales and use tax collection and remittance obligations that exist independently of [the Agreement] registration. However, neither current member states nor withdrawn or expelled member states may use a seller's registration and collection of tax under [the Agreement] as a factor in determining whether the seller has nexus with the State "for any tax at any time."

A state adopting the Agreement must adopt the necessary technology with respect to registrations completed via the online system and accept voluntary registrations under a simplified uniform application that may not require all the information required on its present registration application.

Adoption of the Agreement will require the Department to address various issues from a technology (computer/systems) perspective, including four main systems:

- Registration
- Rates & Boundaries,
- Sales filing and payment, and
- Information Reporting

Registration: Registration is “streamlined,” in that, the Department would receive abbreviated information compared to the data the Department currently receives in its Business Tax Registration (“BTR”) system or plans to receive in the South Carolina Integrated Tax System (“SCITS”) it is developing. The Department will need to build a new registration system – or a sub-system within BTR/SCITS - to accept, store, and deal with this abbreviated set of data, while still keeping its full registration system for entities with other tax types or with nexus. From an operational standpoint, the Department’s registration unit will need to validate the streamlined registrations to determine whether full registration is in fact required for the taxpayer. From an audit standpoint, we will not have, for example, any data on owners or officers.

Rates & Boundaries: States are required to provide a database which assigns each physical address, at least to the zip+4 level, to its taxing jurisdictions, and then to cross-reference each jurisdiction to its tax rate(s). If this is not done, streamlined sellers can use any “reasonable” means to determine the jurisdiction of a mail order or Internet sale, and the local jurisdictions may or may not get all of the local sales and use taxes to which they are entitled. (For example, when a zip code crosses county boundaries.) This database will not be easy to construct since some counties still do not have complete GIS mapping. The Department may have to purchase or certify a database from a vendor, which will be a significant cost and still not be perfect. States have struggled with this.

Sales Filing & Payment: The current sales tax system in the Department system (known as SCATS – South Carolina Automated Tax System) has encoded South Carolina’s current sales tax law. Therefore, to the extent the law is amended to comply with the Agreement in such areas as changing allowable deductions, eliminating caps, changing some calculations, then the system will have to be rewritten to accommodate the changes. The timing could create problems with SCITS, unless the decision to adopt the Agreement is made immediately, since Sales is one of the first systems planned to go live, in September 2008. SCITS resources are then expected to be devoted to the remaining systems, such as Individual Income Tax (“IIT”) and Corporate Income Tax. If the Department has to implement the sales component of SCITS, and then turn around and re-implement because of adoption of the Agreement, it could extend SCITS by a year and several million dollars.

Additionally there are the differences between streamlined filing and regular filing – just as in Registration, the Department would have to build an alternative system to receive and process abbreviated streamlined returns as well as maintaining the system to receive

full returns from non-streamlined sellers - unless the Department decided to collect less information from all taxpayers.

Information Reporting: Since the Agreement's Simplified Electronic Return (SER) is in fact abbreviated, the Agreement allows states to require a semi-annual Information Report to gather the rest of the information. This means, for example, that a break-out of deductions and exemptions claimed would only be available every six months as well as the breakout by location for those bricks-and-mortar establishments which are eligible to file under streamlined. The Department will have to build a new sub-system within Sales Tax to receive and process the Information Returns, and to reconcile them to the SERs. This will impact how auditors do their jobs, and how the Data Warehouse is loaded and utilized for sales tax filers.

Current South Carolina Law

Presently, seller registering with South Carolina must (1) complete a Form SCTC – 111 and mail it to the Department's License and Registrations Section, (2) complete a Form SCTC – 111 and deliver it to the Department's main office in Columbia or one of its regional or satellite offices throughout the state, or (3) register online at SCBOS⁶² (South Carolina Business One-Stop).

Code Section 12-36-510 concerns a seller's requirement to register and obtain a retail license, and states in part:

(A) Before engaging in business:

(1) Every retailer shall obtain a retail license for each permanent branch, establishment, or agency and pay a license tax of fifty dollars for each retail license at the time of application.

Statutory Changes Needed for South Carolina to Comply

In order to comply with the registration requirements of the Agreement, South Carolina will need to do the following:

⁶² The SCBOS Web site (www.scbos.com) is a collaboration of several state and federal agencies and private entities that have a commitment to reducing red tape and ensuring more simplicity for historically complicated and time-consuming tasks necessary to open a business. The site will allow for an electronic "one-stop shop" for South Carolina businesses to register and obtain permits and licensing more quickly and efficiently. In addition to registration, licensing, and renewals, the SCBOS site also will serve as a primary source/point of information and resources for entrepreneurs who are seeking guidance in opening a business in South Carolina.

- Amend the law to authorize Department to participate with other member states on-line registration system that registers a seller in all member states when registered in one.
- Amend law to waive the \$50 license retail license fee if the seller who registers is not engaged in business in South Carolina or does not have “nexus” with South Carolina and to allow these same sellers to cancel registration under uniform procedures adopted by member states.
- Amend law to allow an agent to register a seller under uniform procedures adopted by member states.

3. Exemption administration

Agreement Requirement

The Agreement requires the adoption of a uniform exemption certificate (see certificate below) which covers both entity and use-based exemptions. The certificate is available in both a paper and an electronic format.

The Agreement also requires the adoption of uniform rules concerning exemption certificates. The seller is relieved of liability (except in the cases of fraud) with respect to an exempt sale provided he receives a completed exemption certificate from the purchaser.

Section 317 of the Agreement concerns exemption certificates and states:

- A. Each member state shall observe the following provisions when a purchaser claims an exemption:
 1. The seller shall obtain identifying information of the purchaser and the reason for claiming a tax exemption at the time of the purchase as determined by the governing board.
 2. A purchaser is not required to provide a signature to claim an exemption from tax unless a paper exemption certificate is used.
 3. The seller shall use the standard form for claiming an exemption electronically as adopted by the governing board.
 4. The seller shall obtain the same information for proof of a claimed exemption regardless of the medium in which the transaction occurred.

5. A member state may utilize a system wherein the purchaser exempt from the payment of the tax is issued an identification number that shall be presented to the seller at the time of the sale.
 6. The seller shall maintain proper records of exempt transactions and provide them to a member state when requested.
 7. A member state shall administer use-based and entity-based exemptions when practicable through a direct pay permit, an exemption certificate, or another means that does not burden sellers.
- B. Each member state shall relieve sellers that follow the requirements of this section from any tax otherwise applicable if it is determined that the purchaser improperly claimed an exemption and to hold the purchaser liable for the nonpayment of tax. This relief from liability does not apply to a seller who fraudulently fails to collect the tax or solicits purchasers to participate in the unlawful claim of an exemption.

The above provisions abandoned the “good faith” requirement imposed in many states and establish standards for administering exemptions (including a requirement for states to honor blanket exemption certificates).

Traditionally, in most states, if a seller accepted an exemption certificate in “good faith,” then the seller was relieved of any tax liability with respect to transactions involving that certificate. If the seller accepted the exemption certificate in “good faith,” the state would have to assess the purchaser for any tax due if the exemption certificate was used to purchase an item that did not qualify for the exemption.

As stated in *Hellerstein and Swain*, this “traditional solution has worked reasonably well, but sellers under audit have remained haunted by two overarching issues: (1) determining what is a validly executed exemption certificate and (2) determining what constitutes “good faith” acceptance of a certificate. Nonuniform rules across the states add to this burden.”

However, states may still require rules concerning purchaser’s updating exemption certificates from time to time. Once a state becomes a member, it must allow at least 6 month for sellers to obtain from their purchasers the new certificate or to update the certificates it the seller has on file.

Streamlined Uniform Exemption Certificate (Next Page)

This is a multistate form. Not all states allow all exemptions listed on this form. Purchasers are responsible for knowing if they qualify to claim exemption from tax in the state that would otherwise be due tax on this sale. The seller may be required to provide this exemption certificate (or the data elements required on the form) to a state that would otherwise be due tax on this sale.

The purchaser will be held liable for any tax and interest, and possibly civil and criminal penalties imposed by the member state, if the purchaser is not eligible to claim this exemption. A seller may not accept a certificate of exemption for an entity-based exemption on a sale made at a location operated by the seller within the designated state if the state does not allow such an entity-based exemption.

1. Check if you are attaching the Multistate Supplemental form.
 If not, enter the two-letter postal abbreviation for the state under whose laws you are claiming exemption.
2. Check if this certificate is for a single purchase and enter the related invoice/purchase order # _____.

3. Please print

Name of purchaser _____			
Business Address _____	City _____	State _____	Zip Code _____
Purchaser's Tax ID Number _____		State of Issue _____	
Country of Issue _____			
If no Tax ID Number	FEIN	Driver's License Number/State Issued ID Number	Foreign diplomat number
Enter one of the following: _____ _____ _____			
Name of seller from whom you are purchasing, leasing or renting _____			
Seller's address _____		City _____	State _____
		Zip code _____	

4. Type of business. Circle the number that describes your business

- | | |
|---|---|
| <p>01 Accommodation and food services</p> <p>02 Agricultural, forestry, fishing, hunting</p> <p>03 Construction</p> <p>04 Finance and insurance</p> <p>05 Information, publishing and communications</p> <p>06 Manufacturing</p> <p>07 Mining</p> <p>08 Real estate</p> <p>09 Rental and leasing</p> <p>10 Retail trade</p> | <p>11 Transportation and warehousing</p> <p>12 Utilities</p> <p>13 Wholesale trade</p> <p>14 Business services</p> <p>15 Professional services</p> <p>16 Education and health-care services</p> <p>17 Nonprofit organization</p> <p>18 Government</p> <p>19 Not a business</p> <p>20 Other (<i>explain</i>) _____</p> |
|---|---|

5. Reason for exemption. Circle the letter that identifies the reason for the exemption.

- | | |
|--|--|
| <p>A Federal government (<i>department</i>) _____</p> <p>B State or local government (<i>name</i>) _____</p> <p>C Tribal government (<i>name</i>) _____</p> <p>D Foreign diplomat # _____</p> <p>E Charitable organization # _____</p> <p>F Religious or educational organization # _____</p> <p>G Resale # _____</p> | <p>H Agricultural production # _____</p> <p>I Industrial production/manufacturing # _____</p> <p>J Direct pay permit # _____</p> <p>K Direct mail # _____</p> <p>L Other (<i>explain</i>) _____</p> |
|--|--|

6. Sign here. I declare that the information on this certificate is correct and complete to the best of my knowledge and belief.

Signature of Authorized Purchaser	Print Name Here	Title
Date		

The above form is subject to change as determined by the Governing Board.

Current South Carolina Law

The requirements for exemption and direct pay certificates are found in Code Section 12-36-2510, which states:

(A)(1) Notwithstanding other provisions of this chapter, the department, at its discretion, may issue or authorize for the efficient administration of the sales and use tax law any type of certificate allowing a taxpayer to purchase tangible personal property tax free and be liable for any taxes.

(2) In addition to any other type of certificate the department considers necessary to issue, the department may issue at its discretion:

(a) Direct Pay Certificate: a direct pay certificate allows its holder to make all purchases tax free and to report and pay directly to the department any taxes due. The holder of a direct pay certificate is liable for any taxes due. If an exemption or exclusion is not applicable, the tax is due upon the withdrawal, use, or consumption of the tangible personal property purchased with the certificate.

(b) Exemption Certificate: an exemption certificate, as opposed to allowing its holder to make all purchases tax free, allows its holder to make only certain purchases tax free such as machinery, electricity, or raw materials. The holder of an exemption certificate is liable for any taxes due. If an exemption or exclusion is not applicable, the tax is due upon purchase, or upon the withdrawal, use, or consumption of the tangible personal property purchased with the certificate if the application of the exemption or exclusion cannot be determined at the time of purchase.

(B) To reduce the complexity and administrative burden of transactions exempt from sales or use tax, the following provisions must be followed when a purchaser claims an exemption by use of an exemption certificate:

(1) the seller shall obtain at the time of the purchase any information determined necessary by the department, including the reason the purchaser is claiming a tax exemption or exclusion;

(2) the department, at its discretion, may utilize a system where the purchaser exempt from the payment of the tax is issued an identification number which must be presented to the seller at the time of the sale;

(3) the seller shall maintain proper records of exempt or excluded transactions and provide them to the department when requested and in the form requested by the department.

(C) A seller that complies with the provisions of this section is relieved from any tax otherwise applicable if it is determined that the purchaser improperly claimed an exemption or exclusion by use of a certificate, provided the seller fraudulently did not fail to collect or remit the tax, or both, or solicit a purchaser to participate in an unlawful claim of an exemption. The liability for any tax shifts to the purchaser who improperly claimed the exemption or exclusion by use of the certificate.

Statutory Changes Needed for South Carolina to Comply

South Carolina must amend Code Section 12-36-2510 and forms to comply with the exemption certificate provisions of the Agreement. These changes will restrict the information the Department may require sellers to obtain from purchasers claiming an exemption, but it will not require any significant policy changes.

4. Tax returns

Agreement Requirement

The Agreement provides that states can only require sellers to file one sales tax return per state for each reporting period. Both state taxes and local taxes would be reported on the one return. Sellers must be allowed at least 20 days after the month to file the return.

In addition, states must allow a uniform simplified electronic return that Model 1, 2 or 3 sellers may elect to use instead of the state's standard return.⁶³

Section 318 of the Agreement states:

Each member state shall:

- A. Require that only one tax return for each taxing period for each seller be filed for the member state and all the taxing jurisdictions within the member state.
- B. Require that returns be due no sooner than the twentieth day of the month following the month in which the transaction occurred.
- C. Allow any Model 1, Model 2, or Model 3 seller to submit its sales and use tax returns in a simplified format that does not include more data

⁶³ In Model 1 and 2, third parties perform some or all of the seller's sales tax functions and are discussed in Section F of this report.

fields than permitted by the governing board. A member state may require additional informational returns to be submitted not more frequently than every six months under a staggered system developed by the governing board.

- D. Allow any seller that is registered under the Agreement, which does not have a legal requirement to register in the member state, and is not a Model 1, 2, or 3 seller, to submit its sales and use tax returns as follows:
 - 1. Upon registration, a member state shall provide to the seller the returns required by that state.
 - 2. A member state may require a seller to file a return anytime within one year of the month of initial registration, and future returns may be required on an annual basis in succeeding years.
 - 3. In addition to the returns required in subsection (D)(2), a member state may require sellers to submit returns in the month following any month in which they have accumulated state and local tax funds for the state in the amount of one thousand dollars or more.
- E. Participate with other member states in developing a more uniform sales and use tax return that, when completed, would be available to all sellers.
- F. Require, at each member state's discretion, all Model 1, 2, and 3 sellers to file returns electronically. It is the intent of the member states that all member states have the capability of receiving electronically filed returns by January 1, 2004.

Sections 319, 320 and 325 include other related provisions concerning uniform rules for the remittance of funds, uniform rules for the recovery of bad debts, and uniform customer refund provisions.

In discussing the issue of “returns and remittances,” *Hellerstein and Swain* provides a good summary (Pages 7-12 through 7-13) and states:

Consistent with the theme of state-level administration, member states may require only one tax return per tax period, due no earlier than the twentieth day of the month after the month in which the transaction occurred. Model 1, 2, or 3 sellers may use a simplified format approved by the Governing Board. States may require periodic informational returns no more frequently than every six months under a staggered system to be developed by the Governing Board

Simplified reporting procedures are allowed for registered non-Model 1, 2, or 3 sellers who have no legal obligation to register with the state. States must provide such sellers with the return forms required by the state as well as allow sellers to file annual returns unless the accumulated tax for any given month equals or exceeds \$1,000. A state may require these low-sales-volume non-Model 1, 2, or 3 voluntary registrants to file the first return anytime within the first year of registration.

Ideally, a uniform form will be developed that can be filed electronically. Presently, [the Agreement] commits member states to participate in developing such a form and permits states to require all Model 1, 2, and 3 sellers to file returns electronically. Although [the Agreement] expressed the member states intent that they be capable of receiving electronically filed returns by January 1, 2004, as a late 2006, the governing Board was still in the process of developing uniform and electronically fileable returns.

[The Agreement] also includes uniform remittance rules aimed in large part at facilitating electronic payments. Member states may require only one remittance per return unless the seller collected more than \$30,000 in sales and use tax in the member state during the preceding calendar year. Member states may require Model 1, 2 and 3 sellers to remit taxes electronically. Further, member states must allow electronic payments by both ACH (automated clearinghouse) credit and debit, and they must provide an alternative method for making “same day” payments if an electronic funds transfer fails. If a due date falls on a legal banking holiday, the taxes are not due until the next succeeding business day. Member states must require that any data that accompany a remittance be formatted using uniform tax-type and payment-type codes approved by the Governing Board.

Current South Carolina Law

Generally, sellers file monthly tax returns with the Department which are due by the 20th day of the month following the end of the month in which the sale occurred (Code Section 12-36-2570). Retailers whose liability does not exceed \$100.00 for any month may file quarterly if authorized by the Department (Code Section 12-36-2580).

In addition, the Department has the authority to require returns and remittances for other than monthly periods (Code Section 12-36-2590). If warranted, the Department allows seasonal returns.

Pursuant to Code Section 12-54-250, the Department does require any person owing fifteen thousand dollars or more in connection with any return, report, or other document to pay the tax liability in funds which are available immediately to the State.

Payment in immediately available funds is discussed in SC Revenue Procedure #06-1 and means cash, credit card, or payment by electronic means as follows:

Credit card: The Department accepts payment by credit card for some taxes which allows the taxpayer to receive an authorization code to acknowledge successful processing of the credit card payment. Information as to the types of credit cards that may be used to make a tax payment can be found on the Department's website (www.sctax.org). There is no additional cost to submit payment by credit card.

Electronic Funds Transfer (EFT): The Department has designated two methods of electronic funds transfers from which taxpayers may choose, both of which are offered through the Automated Clearing House (ACH).

1. The first option, the Automated Clearing House Debit, allows the taxpayer to authorize the State to electronically transfer tax payments from the taxpayer's depository into the State's account. (This method may be referred to as "Electronic Funds Withdrawal (EFW)" on some programs.) The cost of this option is charged to the State.
2. The second option, the Automated Clearing House Credit, involves the taxpayer instructing a depository or currency management provider to transfer the funds to the State at such time to assure the State's receipt of the funds by the due date. The cost of this option is charged to the taxpayer.

Note: A third form of electronic funds transfer, Federal Wire transfers (FEDWIRE), will be an acceptable payment method if the ACH Credit or ACH Debit transactions fail (for example, if there is a problem transmitting the information to the clearinghouse or if the computer lines are down for some reason). The taxpayer must first contact the Electronic Services Helpdesk by calling 1-(800) 476-0311 or (803) 898-5740 before proceeding with a wire transfer.

Other Methods: The Department may authorize other methods of payments in immediately available funds as it deems necessary.

The Department also has programs for filing sales tax returns online. For more information, see the Department website (www.sctax.org).

Statutory and Other Changes Needed for South Carolina to Comply

South Carolina filing statutes would need to be amended to allow for the various Agreement provisions concerning Model sellers and Certified Service Providers, filing returns and making payments.

The Department would also need to comply with any “uniform” tax return that may be required by the Governing Board. This may also require changes in the DOR computer and processing systems for sales and use taxes as well as new replacement taxes created to deal with different sales tax rates on certain items or services (e.g., sales tax on accommodations).⁶⁴ In addition, provisions of South Carolina law concerning electronic payments, frequency of payments, etc. would need to be amended to deal with the new information returns and any other requirements of the Agreement.

5. Rounding

Agreement Requirement

States employ different methods in determining the proper tax due on a sale when the calculated tax amount includes a fraction of one cent. This affects how businesses program cash registers and computer systems.

To create uniformity, Section 324 of the Agreement requires that each member state employ the same rounding method, and states:

- A. After December 31, 2005, each member state shall adopt a rounding algorithm that meets the following criteria:
 - 1. Tax computation must be carried to the third decimal place, and
 - 2. The tax must be rounded to a whole cent using a method that rounds up to the next cent whenever the third decimal place is greater than four.
- B Each state shall allow sellers to elect to compute the tax due on a transaction on an item or an invoice basis, and shall allow the rounding rule to be applied to the aggregated state and local taxes. No member state shall require a seller to collect tax based on a bracket system.

Current South Carolina Law

Code Section 12-36-940 establishes the amount of tax that may be added to a sales and states:

- (A) Each retailer may add to the sales price as a result of the five percent state sales tax:

⁶⁴ See Section X, Impact on the Department of Revenue, of this report for a discussion on the impact of the Agreement from a Department computer/systems perspective with respect to registration, rates and boundaries, sales filing and payment, and information reporting.

- (1) no amount on sales of ten cents or less;
- (2) one cent on sales of eleven through twenty cents;
- (3) two cents on sales of twenty-one through forty cents;
- (4) three cents on sales of forty-one through sixty cents;
- (5) four cents on sales of sixty-one through eighty cents;
- (6) five cents on sales of eighty-one cents through one dollar;
- (7) one cent additional for each twenty cents or major fraction of it over one dollar.

(B) The inability, impracticability, refusal, or failure to add these amounts to the sales price and collect them from the purchaser does not relieve the taxpayer from the tax levied by this article.

(C) For purposes of the state sales tax on accommodations and applicable combined state sales and local tax for counties imposing a local sales tax collected by the department on their behalf, retailers may add to the sales price an amount equal to the total state and local sales tax rate times the sales price. The amount added to the sales price may not be less than the amount added pursuant to subsection (A). In calculating the tax due, retailers may round a fraction of more than one-half of a cent to the next whole cent and a fraction of a cent of one-half or less must be eliminated. The inability, impracticability, refusal, or failure to add the tax to the sales price as allowed by this subsection and collect them from the purchaser does not relieve the taxpayer of his responsibility to pay tax. (Emphasis added.)

Statutory Changes Needed for South Carolina to Comply

In order to comply with the rounding provisions of the Agreement, South Carolina would need to amend its rounding provisions in Code Section 12-36-940 for calculating the tax.

6. Audit

Agreement Requirement

The Agreement does not contain audit procedures but it is expected that such procedures will be developed in the future by the Governing Board. However, audits can only be conducted by a single state agency or someone authorized by it.

The Agreement does not require multistate joint audits by the member states at this time, but they have been discussed.

Current South Carolina Law

The administration and collection responsibilities for the state and local sales and use taxes, including audits, rest with the South Carolina Department of Revenue.

Statutory Changes Needed for South Carolina to Comply

No statutory changes would be required at this time. If, however, the Governing Board establishes audit guidelines in the future, statutory changes may be necessary.

F. Collection and Collection Allowances / Refunds

1. Collection and Service Providers

Agreement Requirement

Technology is a key element in the Agreement. Section 403 of the Agreement concerns the three new technology models available to sellers that register under the Agreement, and describes these models as follows:

- A. MODEL 1, wherein a seller selects a Certified Service Provider (CSP) as an agent to perform all the seller's sales or use tax functions, other than the seller's obligation to remit tax on its own purchases.
- B. MODEL 2, wherein a seller selects a Certified Automated System (CAS) to use which calculates the amount of tax due on a transaction.
- C. MODEL 3, wherein a seller utilizes its own proprietary automated sales tax system that has been certified as a CAS.

Section 501B of the Agreement allows the Governing Board to certify persons as CSPs if they meet the following requirements:

1. The person uses a CAS;
2. The person integrates its CAS with the system of a seller for whom the person collects tax so that the tax due on a sale is determined at the time of the sale;
3. The person agrees to remit the taxes it collects at the time and in the manner specified by the member states;
4. The person agrees to file returns on behalf of the sellers for whom it collects tax;

5. The person agrees to protect the privacy of tax information it obtains in accordance with Section 321 of the Agreement; and
6. The person enters into a contract with the member states and agrees to comply with the terms of the contract.

The Certified Automated System (CAS) is a software program that determines the applicable tax rate, if an item is exempt, and the tax to be remitted. It also creates the reports and returns required by the Governing Board.

A seller participating under the Agreement, and therefore subject to taxation in all member states, may select one of these models or continue with its current method of remitting the tax.

Model 1 sellers essentially transfer their sales tax responsibilities to a CSP who is liable for any sales tax due on sales it processes and for which tax has been remitted to it by the seller. States are limited to auditing the CSP to determine any tax due. The Model 1 seller is relieved of the tax liability on such transactions, the cost of compliance, and audits. The Model 1 seller may still, however, be audited by a state for use tax liabilities

Even though the Agreement contains privacy provisions, the Agreement requirement that CSPs collect data on each sales transaction processed by their system has raised privacy concerns.

States will also compensate Certified Service Providers for the costs of providing this service to Model 1 sellers that do not have nexus with the state. The compensation is determined by the Governing Board and is subject to change.

Section 601 of the Agreement concerns the compensation and states:

- A. Each member state shall provide a monetary allowance to a CSP in Model 1 in accordance with the terms of the contract between the governing board and the CSP. The details of the monetary allowance will be provided through the contract process. The governing board shall require that such allowance be funded entirely from money collected in Model 1.
- B. The contract between the governing board and a CSP may base the monetary allowance to a CSP on one or more of the following:
 1. A base rate that applies to taxable transactions processed by the CSP.
 2. For a period not to exceed twenty-four months following a voluntary seller's registration through the Agreement's central registration process, a percentage of tax revenue generated for a member state by

the voluntary seller for each member state for which the seller does not have a requirement to register to collect the tax.

Sellers using a Certified Automated System (Model 2) that do not have nexus with the state receive a monetary allowance for up to two years after they register under the Agreement.

Section 602 of the Agreement concerns the monetary allowance for a Model 2 seller and states:

The member states initially anticipate that they will provide a monetary allowance to sellers under Model 2 based on the following:

- A. All sellers shall receive a base rate for a period not to exceed twenty-four months following the commencement of participation by a seller. The base rate will be set after the base rate has been established for Model 1. This allowance will be in addition to any discount afforded by each member state at the time.
- B. The member states anticipate a monetary allowance to a Model 2 Seller based on the following:
 1. For a period not to exceed twenty-four months following a voluntary seller's registration through the Agreement's central registration process, a percentage of tax revenue generated for a member state by the voluntary seller for each member state for which the seller does not have a requirement to register to collect the tax.
 2. Following the conclusion of the twenty-four month period, a seller will only be entitled to a vendor discount afforded under each member state's law at the time the base rate expires. (Emphasis added.)

Section 603 of the Agreement concerns Model 3 sellers and voluntary sellers that do not use one of the technology models, and states:

The member states anticipate that they will provide a monetary allowance to sellers under Model 3 and to all other sellers that are not under Models 1 or 2 based on the following:

- A. For a period not to exceed twenty-four months following a voluntary seller's registration through the Agreement's central registration process, a percentage of tax revenue generated for a member state by the voluntary seller for each member state for which the seller does not have a requirement to register to collect the tax.

B. Vendor discounts afforded under each member state's law.

The compensation authorized by the Governing Board at this time for CSPs is based on the total tax remitted in all member states. Compensation is authorized for CSPs at the following rates:

<u>Tax Remitted Per Seller for All Member States</u>	<u>Compensation Rates (% of Tax)</u>
Less than or Equal to \$250,000	8%
Greater than \$250,000 and Less than or Equal to \$1,000,000	7%
Greater than \$1,000,000 and Less than or Equal to \$2,500,000	6%
Greater than \$2,500,000 and Less than or Equal to \$5,000,000	5%
Greater than \$5,000,000 and Less than or Equal to \$10,000,000	4%
Greater than \$10,000,000 and Less than or Equal to \$25,000,000	3%
Greater than \$25,000,000	2%

These monetary allowances apply only to “voluntary sellers” as defined in the contract negotiated by the Governing Board with respect to compensation.

For example, CSPs would not be compensated based on the above for tax collected for sellers that have a store, or other physical presence, in the state and that are already registered in the state. As such, there is no incentive for a CSP to service sellers that make mostly in-state sales unless the sellers pay them. Therefore, Model 1 will likely be used predominantly by remote (i.e., non-nexus mail order and Internet) sellers. States may, however, provide additional compensation to CSPs. In addition, sellers may pay for the service to obtain relief from the liability and could also possibly negotiate lower rates.

Model 2 sellers, sellers using proprietary software, and sellers that voluntarily register under the Agreement will only receive a monetary allowance for twenty-four months. This may be in addition to any discount allowed by the state, unless state law is amended.

Current South Carolina Law

South Carolina law does not address the Agreement’s technology models and does not allow the same compensation allowed by the Governing Board.

The discount provisions for sellers are found in Code Section 12-36-2610, which states:

When a sales or use tax return required by Section 12-36-2570 and a local sales and use tax law administered and collected by the department on behalf of a local jurisdiction is filed and the taxes due on it are paid in full on or before the final due date, including any date to which the time for making the return and paying the tax has been extended pursuant to the

provisions of Section 12-54-70, the taxpayer is allowed a discount as follows:

(1) on taxes shown to be due by the return of less than one hundred dollars, three percent;

(2) on taxes shown to be due by the return of one hundred dollars or more, two percent.

In no case is a discount allowed if the return, or the tax on it is received after the due date, pursuant to Section 12-36-2570, or after the expiration of any extension granted by the department. The discount permitted a taxpayer under this section may not exceed three thousand dollars during any one state fiscal year. However, for taxpayers filing electronically, the discount may not exceed three thousand one hundred dollars. A person making sales into this State who cannot be required to register for sales and use tax under applicable law but who nevertheless voluntarily registers to collect and remit use tax on items of tangible personal property sold to customers in this State is entitled to a discount on returns filed as otherwise provided in this section not to exceed ten thousand dollars during any one state fiscal year.

Statutory Changes Needed for South Carolina to Comply

South Carolina would need to amend its law to authorize the three technology models and the payment of compensation under contract approved by the Governing Board.

In addition, South Carolina would need to address the additional cost of implementing these technology models (computer re-programming, etc.) and the cost of the additional monetary compensation provided under these models.⁶⁵

2. Refunds

Agreement Requirement

The Agreement does not address refunds under the three technology models; however, it does address state provisions that allow the purchaser to seek a refund from the seller (Section 302 of the Agreement).

⁶⁵ See Section X, Impact on the Department of Revenue, for a discussion on the impact of the Agreement from a Department computer/systems perspective with respect to registration, rates and boundaries, sales filing and payment, and information reporting.

Current South Carolina Law

South Carolina has very specific provisions concerning refunds, but these provisions do not address refunds involving the three technology models.

Statutory Changes Needed for South Carolina to Comply

In order to address refund involving the three technology models, provisions of the sales and use tax laws and the Revenue Procedures Act (Chapter 60 of Title 12) will have to be amended.

3. Privacy

In discussing the issue of “privacy,” *Hellerstein and Swain* provides a good summary (Page 7-33) and states:

One of [the Agreement’s] “fundamental purposes” is [p]rotection of consumer privacy.” The privacy issue is most acute with respect to Model 1 sellers, who rely on third-party CSPs to handle their tax-compliance functions and who therefore may be sharing personal information with such CSPs. [The Agreement’s] privacy provisions are specifically directed at consumers who deal with Model 1 sellers. In addition, SSUTA adopts confidentiality provisions applicable to all participants in the streamlined system.

In order to ensure that consumer privacy is protected when CSPs deal with Model 1 sellers, [the Agreement] requires that, with limited exceptions, “a CSP shall perform its tax calculation, remittance, and reporting functions without retaining the personally identifiable information of consumers.” In implementing this directive, [the Agreement] provides that a CSP may be certified only if it confirms that the following conditions have been met:

1. The CSP’s system has been designed and tested to ensure respect for anonymity.
2. Personally identifiable information is used and retained only insofar as necessary for the administration of exemptions, based on the consumer’s status or the intended use of the product.
3. Consumers are notified regarding the CSP’s information practices.
4. There are safeguards in place to protect personally identifiable information from disclosure.

In addition, [the Agreement] imposes a variety of privacy-and confidentiality-related obligations on the states with respect to (1)

notification of consumers regarding the states' practices concerning personally identifiable information; (2) retention of such information; and (3) consumer access to such information.

Current South Carolina Law

South Carolina does not address consumer privacy issues involving the three technology models. However, Code Section 12-54-240 prohibits the release by the Department of information from a retailer's sales and use tax return except in certain specifically listed circumstances.

Statutory Changes Needed for South Carolina to Comply

In order to address consumer privacy issues involving the three technology models, provisions of the sales and use tax laws, Code Section 12-54-240, and the Revenue Procedures Act (Chapter 60 of Title 12) may have to be amended if it is determined that the provisions of the Agreement are not sufficient.

G. Governance

Agreement Requirements

Article IX of the Agreement concerns amendments to, and interpretations of, the Agreement by the Governing Board.

Under these provisions, the Governing Board may amend the Agreement with a three-fourths vote of the entire board. It is expected that, at least during the first few years of the Agreement, the addition of, and amendments to, the Library of Definitions will constitute the majority of these amendments. Proposed amendments to the Agreement may be submitted by any member state or by any other person or organization (e.g., trade associations). Seventeen proposed amendments to the Agreement will be considered at the September 1-20, 2007, Governing Board meeting.

Matters involving interpretation of the Agreement may be submitted to the board by any member state or any other person. Such interpretations may be issued as interpretative opinions or interpretative rules. Interpretative opinions are similar to revenue rulings and interpretative rules are similar to regulations issued to clarify statutory language. Both will require three-fourths vote of the entire board and shall be considered a part of the Agreement and have the same effect as the Agreement.

Article X of the Agreement requires the Governing Board to establish rules creating an issue resolution process. This process will be used to resolve matters of:

- Membership of a state
- Matters of compliance of a state
- Sanctions of a member state

- Amendments to the Agreement
- Interpretation issues, including differing interpretations among the member states
- Other matters at the discretion of the Governing Board

Decisions of the Governing Board are final and not subject to further review.

Current South Carolina Law

The South Carolina Department of Revenue issues advisory opinions in the form of revenue rulings, revenue procedures, and private letter rulings. They are intended to provide the public with guidance as to the Department's position so members of the public will not be surprised by its opinion and to ensure that the Department's position is the same from office to office and employee to employee.

These advisory opinions remain in effect unless superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion.

The Department also promulgates regulations. In South Carolina, regulations are sent to the General Assembly for consideration after a specific statutory notice and hearing process an agency must follow before the proposed regulation is even submitted to the General Assembly.

Finally, assessments by the Department (including refund, exemption and license denials) are subject to review by the Administrative Law Court, the Court of Appeals and the South Carolina Supreme Court.

Statutory Changes Needed for South Carolina to Comply

If South Carolina were to enact legislation to comply with the Agreement and the Governing Board were to accept our petition for membership, then South Carolina would be required to abide by the Agreement and all legal interpretations involving the Agreement (e.g., definition of food, certain tax terms, sourcing rules, etc.) and could only enact sales tax legislation and regulations that are in compliance with the Agreement and Governing Board interpretations. Compliance must be maintained and is reviewed each year and any state that is not in compliance is subject to expulsion from the Board and would therefore no longer be a participant in the Agreement.

Guidance as to the interpretation of the Agreement rests with the Governing Board and not with the Department. Taxpayers may have to wait longer to receive guidance from the Governing Board.

With respect to the governing provisions of the Agreement, South Carolina will need to consider the following:

- The interpretations by the Governing Board would, as a practical matter, serve as regulations and that would not comply with the regulation approval process presently established by the General Assembly. These provisions could be amended to provide an exception to the process for the interpretations of the Governing Board; however, this could constitute an unconstitutional delegation of authority.
- The application of the tax if the Administrative Law Court and the appellate courts in South Carolina issue a finding that is contradicted by an interpretation of the Governing Board at a later date or if the Administrative Law Court and the courts in South Carolina issue a finding that contradicts a previously issued interpretation of the Governing Board.
- A provision in proposed federal legislation allows persons who petition the Governing Board on an issue regarding the Agreement to appeal the decision of the Governing Board to the United States Court of Federal Claims or bring an action in the Court if the Governing Board fails to act on the petition. The Court may remand the matter to the Governing Board for action consistent with the Court's decision.

H. Catawba Indian Tribe

There are several possible issues involving the Catawba Indian Reservation. Some amendments may be required to the treaty and the state and federal legislation concerning the Catawba Indian Settlement. This issue will require more research to determine if such changes would be needed. If changes are necessary, they will require negotiations with the Catawba Indian Tribe and discussions with the South Carolina Congressional delegation.

The possible issues involving the Agreement and the Catawba Tribal sales and use taxes are:

- The possibility of two different Tribal tax rates within the reservation if the two counties in which the reservation is located have different local tax rates. This may violate the Agreement's requirement that only one tax rate may exist within a "local" jurisdiction. However, in all likelihood, the Catawba Indian Reservation would be considered a sovereign nation and this would not be a problem.
- Any change in the Catawba Indian Settlement may require negotiations with the Catawba Indian Tribe and changes in both state and federal law. If so, the Tribe may want to negotiate other areas.

- The \$100 gross proceeds limit on the application of the state sales tax from sales off the reservation delivered onto the reservation. The following chart provides a summary of these provisions:

<u>Delivery on the Reservation From:</u>	<u>Type Tax Applicable</u>
Location On the Reservation	Tribal Sales Tax (Equal to Combined State and Local Rate) administered and collected by the DOR
Location Off the Reservation But in SC – Sales \$100 or less	State Sales Tax administered and collected by the DOR. (Local taxes would not be applicable in these circumstances.)
Location Off the Reservation But in SC – Sales Over \$100	Tribal Sales Tax (Equal to Combined State and Local Rate) administered and collected by the DOR
Location Off the Reservation and Outside the State – Seller Registered with DOR	State Use Tax administered and collected by the DOR. (Local taxes would not be applicable in these circumstances.)
Location Off the Reservation and Outside the State – Seller Not Registered with DOR	Tribal Use Tax (Equal to Combined State and Local Rate) administered and collected by the Catawba Indian Tribe.

This may be a cap in violation of the Agreement.

The best argument that these issues are not of concerns is that the Catawba Indian Reservation is not a local jurisdiction, but a sovereign nation not part of South Carolina.

V. Proposed Federal Legislation

Legislation has again been introduced into Congress that would allow the states to require collection of sales and use taxes by out-of-state sellers that do not have a physical presence in the state. Similar legislation has been introduced on and off in Congress over the last several sessions, but has never been enacted.

The most recent version (Senate Bill 34 introduced on May 22, 2007 and the companion House Bill 3396 introduced on August 3, 2007) will allow a state to require collection of the sales and use tax from out-of-state sellers who do not have a physical presence⁶⁶ if certain criteria are met. The proposed legislation essentially requires that the state adopt the Agreement. If a state does adopt the Agreement and this proposed federal legislation is enacted, the provisions of the Commerce Clause would no longer prevent the state from requiring an out-of-state seller to collect and remit the tax.

However, the proposed legislation does enact additional restrictions. These restrictions include an exception for sellers who have less than \$5 million in sales,⁶⁷ compensation for sellers, and a provision authorizing review by the United States Court of Federal Claims with respect to certain matters as set forth in the proposed federal legislation.

Since this proposed legislation is just that – a proposal – its is subject to change and enacted legislation may be substantially different than the current proposals, or the Agreement, if any such legislation is in fact enacted by Congress.

In considering this matter, there are several important points to consider:

- If Congress does not enact legislation, then South Carolina may not see all of the revenue the state is losing via e-commerce even if South Carolina does adopt the Agreement. (Until Congress acts, participation by sellers in the Agreement is voluntary.) .
- The Department presently has registered 20 of the top 25 e-retailers.
- At one time, many “brick and mortar” retailers established “barriers” between their retail store operations and their new Internet sales operations. This reduced the chances of nexus being established with the Internet operation. However, over the last several years, many such businesses have eliminated these barriers (e.g., customers can return Internet purchases to a related “brick and mortar” store).

⁶⁶ Presently, only sellers that have a physical presence in South Carolina can be required by the Department to collect and remit the sales and use tax.

⁶⁷ This exception for sellers who have less than \$5,000,000.00 in sales in a state is generally referred to as the “small business exception.” This is an area of some disagreement. Others prefer an exception that is based on a small business definition designation by the U.S. Small Business Administration. Specifically, in Senate Bill 34 the exception applies to a seller and its affiliates collectively that have gross remote taxable sales nationwide of less than \$5,000,000.00 in the calendar year preceding the date of the remote sale.

These companies made changes for business reasons. These changes established nexus with the Internet operation and they then registered and began remitting taxes with respect to the Internet operations.

- Several states are also enacting “affiliate nexus” statutes that establish nexus with Internet operations that are related to “brick and mortar” stores.
- Proposed federal legislation on this matter over the last decade has always established a floor in which retailer with nationwide sales under a certain amount would not have nexus and would not have to participate in the Agreement. As such, some Internet retailers will never be required to remit taxes to South Carolina.

VI. Policy decisions

A. Bringing SC into compliance

Unlike the legislation enacted in 2002 (Simplified Sales and Use Tax Administration Act – Chapter 35 of Title 12) to allow South Carolina to participate as an Implementing State in the Streamlined Sales Tax Project, adopting the provisions of the Agreement does not merely entail passing a law to enact model legislation. The process will involve enacting many legislative changes to the sales and use tax code and other provisions of law in South Carolina. These changes will be needed to align the sales and use tax definitions and administrative procedures with the Agreement. South Carolina's sales and use tax law revised to comply with the Agreement may look substantially different than the present sales and use tax law.

As stated earlier in this report, South Carolina presently does not comply with a large number of the Agreement's provisions. And, documenting compliance is the first step necessary to becoming a member state of the Agreement. In addition, states must make sure that conformity with the Agreement is maintained.

Making the changes to adopt the Agreement's provisions affects all taxpayers, not just out-of-state sellers. These implications even affect manufacturers that do not ordinarily make taxable sales, since they must follow the Agreement's administrative procedures for claiming an exemption.

South Carolina will also need to develop new procedures and technologies involving the online registration system, tax amnesty, and rate and ZIP code databases.⁶⁸ Other such issues involve the requirement for a single state tax rate, eliminating caps and thresholds, and a uniform state and local tax base. Many policy decisions will need to be made by the General Assembly in order to comply with the Agreement, including decisions on what to impose the tax on and what to exempt from the tax. While some decisions may be small, they will all impact specific taxpayers and interests.

These decisions could be based on specific tax policy objectives. Compliance with the Agreement will simplify some aspects of state and local sales and use tax, such as the requirement that all local taxes have the same tax base (same impositions, same exemptions, etc.) However, compliance will require other policy decisions that will provide a new level of complexity for current taxpayers, such as new definitions, new procedures, and new replacement taxes that may be enacted to maintain revenue.

Many decisions will need to be made. Examples as mentioned previously in this report include:

⁶⁸ See Section X, Impact on the Department of Revenue, of this report for a discussion on the impact of the Agreement from a Department computer/systems perspective with respect to registration, rates and boundaries, sales filing and payment, and information reporting.

- An amendment to various statutes (state and local) so that the state tax and all local taxes either (1) exempt unprepared food in accordance with the definitions and provisions of the Agreement, (2) tax unprepared food in accordance with the definitions and provisions of the Agreement, or (3) exempt such unprepared food from the state tax, but tax such unprepared food under all local sales and use taxes.⁶⁹ Presently, some local taxes exempt food eligible to be purchased with USDA food stamps.⁷⁰
- South Carolina presently taxes software (prewritten or custom) when delivered in tangible form and does not tax software (prewritten or custom) when delivered electronically. The Agreement includes prewritten software within the definition of tangible personal property; therefore, prewritten software, whether in tangible form or delivered electronically, will be subject to the tax unless the General Assembly exempts it (the Agreement allows the exemption of all prewritten software or a limited exemption for prewritten software delivered electronically). Custom software would not be taxed under the Agreement unless the General Assembly imposed the tax on the service of creating and selling custom software.
- An amendment to the state law to do one of the following: (1) lower the 7% state tax rate for the sales tax on accommodation to 6%, (2) raise the 6% state tax rate on all other items and services to 7%, or (3) repeal the 7% sales tax on accommodations and create a new separate 7% “lodging” tax. A separate “lodging” tax may require hotels and others providing sleeping accommodations to file several returns – a sales tax return, a lodging tax return, and possibly a local accommodations tax return.
- An amendment to state law so that sales to persons eighty-five years of age and older are taxed at the full tax rate or are completely exempt. Presently, sales to persons eighty-five years and older are taxed a rate 1% less than the full tax rate.
 - An amendment to state and local tax laws to establish uniform start and termination dates for new local tax rates or new local taxes so that such taxes begin on the first day of a calendar quarter and to allow the DOR to provide retailers advanced notice (the Agreement requires 60 and 120 day notice in most instances for local taxes).
- An amendment to various statutes (state and local) so that the state tax and all local taxes either exempt certain maximum tax items⁷¹ or eliminate the maximum

⁶⁹ Section 308 of the Agreement provides a limited exception to uniformity that would allow a member state to exempt “food” or “drugs,” as defined by the Agreement, from the state tax by applying a 0% state tax rate, but to tax such “food” or “drugs” at the local level. However, all local jurisdictions must tax these items under this alternative. Some local jurisdiction may not exempt these items while others tax them as is presently the case in South Carolina with respect to “food.”

⁷⁰ If South Carolina participates in the Agreement, it must use the definitions and provisions established in the Agreement; therefore, the South Carolina could no longer use of the USDA food stamp program in determining the taxation of unprepared food for sales tax purposes. See also Section A.2. of this report concerning “Definitions.”

⁷¹ See also discussion on “Caps and Thresholds” in Section IV, Part B - “Tax Rates.”

tax on these items. Maximum tax items are those items for which the General Assembly has established a maximum sales tax or use tax due with respect to the sale or purchase of certain items. In most cases, the maximum tax due is \$300.00

The items subject to the maximum tax, as listed in Code Section 12-36-2110, are aircraft (including unassembled aircraft kits), motor vehicles, motorcycles, boats, trailers and semitrailers that can only be pulled by truck tractors, horse trailers, recreational vehicles (tent campers, travel trailers, park models, park trailers, motor homes, and fifth wheels), self-propelled light construction equipment limited to a maximum 160 net engine horsepower, manufactured homes, certain musical instruments and office equipment purchased by religious organization, and fire safety education trailers.

Since the Agreement does not apply to motor vehicles, watercraft, aircraft, and modular and manufactured homes, the maximum tax items in question are trailers and semitrailers pulled by a truck tractor, horse trailers, non-motorized recreational vehicles, and musical instruments and office equipment purchased by a religious organization. Therefore, in order to comply with the tax base uniformity provisions of the Agreement, South Carolina must either exempt these items from the state tax and all local taxes or tax these items under state tax and local taxes.

Many other choices like the above would be required to address the areas of nonconformity listed in the previous sections as well as other changes.

B. Maintaining compliance

Sales and use tax laws are continually affected by legislative action, administrative interpretations, and judicial decisions. To ensure such changes do not compromise uniformity, each member state must annually re-certify to the Governing Board that it has maintained compliance with the Agreement. A member state that is not in compliance with the Agreement may be sanctioned by the Governing Board or expelled.

In participating in the Agreement, states must accept that they will need to amend their laws, regulations and interpretations on a continuing basis in order to maintain compliance with the Agreement.

If South Carolina were to come into compliance, petition for membership and be approved by the Governing Board, any future sales and use tax legislation enacted by the General Assembly cannot violate the Agreement without risking expulsion.

1. Changes in the Agreement and Interpretations

The Agreement is not a static document. Since adopted in November 2002, the Agreement has been amended 9 times (4 times in 2006 alone). Additional amendments are likely. Seventeen proposed amendments to the Agreement will be considered at the

September 19-20, 2007, Governing Board meeting. Changes in the Agreement could force South Carolina to either adopt provisions that the General Assembly does not consider to be in the best interest of the State or remove itself from the Agreement.

Interpretations by the Governing Board that differ from South Carolina judicial decisions may require legislation to maintain compliance. Interpretations by the Governing Board will require the state to amend its interpretations as well. Other than the South Carolina's one vote as a member state (if it decides to join and is accepted), South Carolina will have little choice but to accept the Governing Board's interpretation of any provision of the South Carolina sales and use tax law that has been enacted in accordance with the requirements of the Agreement. Two proposed interpretive rules will be considered at the September 19-20, 2007, Governing Board meeting.

If South Carolina refuses to adopt any future amendments to the Agreement or to acquiesce to any of the Governing Board's (or federal court's⁷²) interpretations of the Agreement, it may have to choose to leave or be expelled from the Agreement. Loss of membership in the Agreement would mean:

- Businesses that have registered under the Agreement that do not have a physical presence in South Carolina may stop paying sales taxes to, and collecting use taxes for, South Carolina;
- If federal legislation is enacted that requires businesses without physical presence to pay sales taxes and collect use taxes without physical presence to member states, those businesses that do not have physical presence in South Carolina, would likely stop paying sales taxes to, and collecting use taxes for, South Carolina.

Although these losses may not be as high as some estimates, they are certain to negatively affect our State budget.

These losses may make it financially and politically difficult to fail to conform to any future amendments to, or interpretations of, the Agreement. So if South Carolina joins the Agreement, the Governing Board will become an important participant in South Carolina political life.

In 1991, after Lost Trust became public, the General Assembly enacted Act No. 248. This Act amended our laws on lobbyists and lobbying, on ethics of public officials and employees, and government accountability. As with any, or at least most, government reforms, some people believe these rules go too far and some think they do not go far enough, but they are the rules that our representatives enacted and we have heard no one say that we shouldn't have any rules of this nature.

⁷² If federal legislation is enacted, certain action may be brought against the Governing Board in United States Court of Federal Claims for judicial review of the action of the Governing board (under the most recent legislation introduced in Congress as of the date of this report).

The Agreement has no ethics rules, no rules of accountability for the Governing Board members or their staff, and no lobbying rules. It does not appear that we can correct this lack with South Carolina legislation, since the structure will allow persons to indirectly influence South Carolina law by influencing Governing Board members and staff from other states.

2. South Carolina Court Cases

In discussing the issue of “governance,” *Hellerstein and Swain* (Page 9-1) states:

Although [the Agreement’s] substantive provisions have garnered the lion’s share of attention that the [the Agreement] has thus far commanded, six of [the Agreement’s] twelve articles relate to governance issues. These include [the Agreement’s] initial approval and effective date; subsequent state entry and withdrawal into [the Agreement]; administration of [the Agreement]; [Agreement] procedures; amendments and interpretation of [the Agreement]; issue resolution; [the Agreement’s] relationship to member states and persons; and review of [the Agreement’s] costs and benefits. Governance issues are likely to be a considerable source of controversy and uncertainty both because they raise political as well as legal questions and because the landscape to which these provisions are directed is unexplored. ... [The Agreement] and its Governing Board are works in progress and any analysis of [the Agreement’s] provisions and their implications must, to some extent, be regarded as preliminary and subject to revision.

In addition to the larger issue of governance, there is considerable uncertainty of how the Agreement and the South Carolina courts will affect each other. In other words - what happens if the Administrative Law Court and South Carolina’s appellate courts issue a finding that is contradicted by an interpretation of the Governing Board at a later date, or if the Administrative Law Court and the appellate courts in South Carolina issue a finding that contradicts a previously issued interpretation of the Governing Board?

This may be one of the major unknowns of the affect of the Agreement on individual member states.

VII. Current Issues

There are several issues that are presently being debated by the Governing Board, or that the member states or industry are discussing, that policy makers in South Carolina need to be aware of in making any determining with respect to the Agreement.

Replacement Taxes:

Many states have enacted, either many years ago prior to the concept of a streamlined sales tax or more recently in attempt to comply with the Agreement, excise and other taxes that have the indicia of a sales tax. A replacement tax refers to a tax imposed by a state to, in effect, reinstate a tax that the state had to give up in order to comply with the Agreement. Examples of replacement taxes include: lodging tax, dry cleaning tax, automobile rental tax, communications services tax, local prepared meals taxes, and environmental taxes (tire fees, oil fee etc.). In discussing the issue of “replacement” taxes, *Hellerstein and Swain* states:

Substitute taxes raise two important questions. First, is a member state that adopts a substitute tax in compliance with [the Agreement]? Second, even if it is, will substitute taxes create a sales and use tax environment, broadly construed, that continues to impose a burden on interstate commerce under *Quill*? In addressing these questions, one should draw a distinction between substitute taxes that potentially place additional burdens on remote sellers, such as the Minnesota fur tax, and substitute taxes that are enforceable only against the local buyer, such as the North Carolina manufacturers’ privilege tax. Because [the Agreement] concerns itself largely with seller issues, achieving uniformity with respect to tax collection obligations that fall solely on buyers is arguably outside its scope and purpose. Furthermore, the number of substitute taxes enacted by a particular state or by the states collectively may be relevant.

The issue of replacement taxes has generated much discussion since it is viewed by some as circumventing the purpose of the Agreement. However, as discussed above, some replacement taxes do not place a burden on the remote seller. In the example cited in the above quote, the privilege tax on manufacturers is imposed on the buyer – the manufacturer – and does not impose a burden on remote sellers or interstate commerce while a tax that is imposed upon or requires the seller to collect the tax from the purchaser does create a burden on the remote seller. Although replacement taxes may be viewed as contrary to the purpose of simplification, it should also be remembered that another purpose was, and is, to allow states to join the Agreement and maintain their tax base. Most of the arguments favoring restricting replacement taxes are based on the understandable desire of businesses to pay less in taxes. These arguments favor allowing replacement taxes that permit lower taxes than would otherwise be allowed by the Agreement, and they usually do not object to replacement taxes for services that most states already tax outside of their sales tax (e.g., accommodations or lodging taxes). They

object to taxes that increase taxes beyond what the Agreement would allow, whether to maintain the state's tax base or actually increase the state's tax base.

Two facts should be kept in mind when considering this discussion. First, replacement taxes are not part of the Agreement; therefore, a business without a retail location in the state does not need to collect or pay such replacement taxes even if they constitute a type of "sales" tax. Second, businesses with retail locations in a state may have the influence, through the jobs they create, the products and services they purchase, and the taxes they already pay, to effectively prevent a state from overburdening in-state businesses with multiple replacement taxes, the filing of multiple tax returns, and multiple tax audits.

The issue of replacement taxes has become one of the larger issues with respect to the Agreement and the following briefly outlines concerns about such taxes:

- The enactment of replacement taxes may erode the intent and purpose of the Agreement.

States enacting replacement taxes to comply with the Agreement may be creating an additional burden for sellers – both in-state sellers and remote sellers that have nexus.⁷³ Sellers filing in states that have created replacement taxes may be required to file multiple returns. For example, if a state's sales tax is imposed upon accommodations, communications, or other transactions at a higher tax rate than the general sales tax rate, then it may create a replacement tax that would require the seller to file a sales tax return and a lodging tax return or a sales tax and a communications tax return.

- While industry considers replacement taxes as a problem in general, there are replacement taxes they believe should be allowed.

In its response to the Governing Board on March 9, 2007, the State and Local Advisory Council ("SLAC") states:

"The issue is further complicated by a general perception, which SLAC believes is shared by the [Business Advisory Council], that some replacement taxes should be allowed. Manufacturing equipment, for example, may have received a preferential rate in a state prior to the state's adoption of the Agreement. Such a provision, however, would violate Section 308. It is generally agreed that a replacement tax might be appropriate in that case to preserve an existing benefit to the taxpayers of the state. To date, SLAC's efforts to produce an acceptable definition of "replacement tax" have tried to address this issue. It has proven difficult to define a "replacement tax" as one that would include a new tax that imposes a higher rate on a product, but not include a new tax that preserves a

⁷³ Sellers that do not have nexus with a state but who collect and remit sales and use taxes in that state because of their participation in the Agreement will not be required to collect and remit a replacement tax because it is not under the provisions of the Agreement.

lower rate. It may be preferable to first establish a definition of “replacement tax” and then establish a test to determine which replacement taxes are allowable.”

- Disallowing or limiting replacement taxes would pre-empt the General Assembly.

If the Governing Board creates a definition of “replacement tax” or a list of acceptable and non-acceptable replacement taxes, such might prevent or limit the General Assembly’s ability to enact new tax legislation to meet the unique needs of South Carolina. In addition, it might require the General Assembly to enact legislation to deal with taxes that have been on the books for years that may no longer be acceptable in order to remain in compliance with the Agreement.

- A definition of “replacement tax” may discourage new states from adopting the Agreement.

If the Governing Board adopts a definition of “replacement tax,” it may cause some states to decide against joining. A state may not be willing to join if it is forced to choose between losing substantial revenue and significantly increasing taxes on some of its taxpayers.

Sourcing:

Sourcing continues to be an issue. Not only does it affect the possible membership of other states, it is an area which is constantly being reviewed through amendments submitted by the member states and by industry. Sourcing rules related to direct mail, florists, and a small business exception have been discussed and/or suggested during the last several months.

In addition, the sourcing of local taxes still may be a factor that determines whether certain large states join the Governing Board.

Amendments:

The issue has been raised as to whether or not too many amendments are being proposed with respect to the Agreement.⁷⁴

- Neal Osten, the federal affairs counsel for the National Conference of State Legislatures’ Communications, Technology and Interstate Commerce Committee, told Tax Analysts (January 23, 2007) that “the number of amendments is getting people nervous.” He further stated:

“They are asking, ‘Is the product not finished yet?’ There’s concern about who is making policy. The revenue department says you need to pass this statutory change or you’re out. The fear of the business community is that the tax

⁷⁴ The information and quotes in this section on “Amendments” were obtained from Tax Analysts, January 23, 2007.

administration could be holding a gun to the heads of the legislators. [The National Conference of State Legislature] is sensitive to that concern. We need to get more legislators involved.”

- Jeffrey Hyde, senior tax counsel for GE Capital Corp., in voicing concern about the amendment process noted that:

“Since November 2004, there have been 59 introduced amendments, with 10 more for [the next SLAC and governing board meetings from March 14 to 17 in Charlotte, N.C.]. Every time an amendment goes through, the business community and states have to change.”

- Charles Collins, vice president of government affairs of ADP Taxware, believes the amendment process is working and stated: “The new items are usually definitions.” “Yes, there are a lot of amendments, but most pass unanimously.”
- The following is the list of amendments/issues presented to the Governing Board at its June 2007 meeting for consideration:⁷⁵

Document ID	Document
AM06009	Michigan Amend the definition of delivery charges in the Library of Definitions
AM07001	Utah and Kansas Amend Section 313 relating to Direct Mail Sourcing Rules
AM07002	Kansas Amend Section 305 regarding the Availability of Rate and Boundary Changes
AM07005	Utah adopt new section on behalf of BAC regarding replacement taxes
AM07009	Utah and Kansas Amend Section 327 regarding definition of Direct Mail and Delivery Charges
AM07010	A motion by Oklahoma to amend Section 309 to postpone the sourcing rule as it relates to florists.
AM07011	A motion by Oklahoma and Tennessee to amend Section 502 to clarify effect of software certification.

⁷⁵ In addition, 19 amendments and issues will be considered at the September 19-20, 2007, Governing Board meeting.

- AM07012 A motion by Oklahoma, South Dakota, Kentucky and Michigan to amend the Agreement by adding a new section to Article III relating to the use of specified digital products.
- AM07012A01 A motion by Oklahoma, South Dakota, Kentucky and Michigan to amend the Agreement by adding a new section to Article III relating to the use of specified digital products.
- AM07013 A motion by Oklahoma, Kentucky, Utah, Tennessee and South Dakota to amend Section 327 to clarify effect of new digital product definitions.
- AM07014 A motion by Oklahoma, Kentucky and Michigan to amend the Agreement by adding new definitions to Part II of the Library of Definitions relating to specified digital products
- AM07014A01 A motion by Oklahoma, Kentucky and Michigan to amend the Agreement by adding new definitions to Part II of the Library of Definitions relating to specified digital products
- AM07015 A motion by Oklahoma, South Dakota, Kentucky and Michigan to amend AM070012 relating to specified digital products and the difference between existing states and new states
- AM07016 A motion by Ohio and South Dakota to amend Section 309 relating to sourcing of florist transactions
- AM07017 A motion by Michigan to amend the definition of “delivery charges” and add definitions of “preparation for delivery” and “delivery” in the Library of Definitions
- AM07018 A motion by Indiana and Oklahoma to amend Section 310 of the Agreement relating to approval of alternative sourcing rules
- AM07019 A motion by Indiana, Oklahoma, Kansas and Kentucky to amend Sections 704, 705 and 801 of the Agreement relating to Associate Membership for states applying after January 1, 2007

- AM07019A01 A motion by Indiana, Oklahoma, Kansas and Kentucky to amend Sections 704, 705 and 801 of the Agreement relating to Associate Membership for states applying after January 1, 2007
- AM07020 A motion by Indiana and Oklahoma to amend Section 705 of the Agreement relating to extension of Associate Membership because of Section 310.
- AM07021 A motion by Oklahoma and Indiana to amend Section 804 of the Agreement relating to Associate Membership
- AM07022 A motion by Ohio to amend Section 310 of the Streamlined Sales and Use Tax Agreement relating to Sourcing by providing an alternative statewide tax rate and a small business exception
- AM07023 A motion by Ohio to amend Section 310 of the Streamlined Sales and Use Tax Agreement relating to Sourcing by providing a small business exception
- AM07024 A motion by Ohio to amend Section 310 of the Streamlined Sales and Use Tax Agreement relating to Sourcing by providing an alternative statewide tax rate
- AM07025 A motion by Oklahoma and Tennessee to amend the explanatory language in Part II of Appendix C of the Library of Definitions.
- AM07026 A motion by New Jersey to amend the definition of durable medical equipment.
- AM07027 A motion by Utah to amend the Library of Definitions relating to digital products
- AM07027A01 A motion by Utah to amend the Library of Definitions relating to digital products
- AM07028 A motion by Utah to amend Article III of the Agreement relating to the use of specified digital products.

AM07028A01	A motion by Utah to amend Article III of the Agreement relating to the use of specified digital products.
AD07001	A motion by Utah to add definitions for list services provided or accessed electronically and for lists provided in tangible form.
RP07003	Direct Mail Rule 313
RP07004	Publishing Rule 806.1.7
RP07006	CSP Compliance Rule 806.3
RP07007	Delivery Charge Rule 327.4
RP07008	Direct Mail Definition and Sourcing Rule 313
RP07008A01	Direct Mail Definition and Sourcing Rule 313
RP07009	Digital Products Rule 332.1
RP07010	Purchaser Liability Rule

Digital Products:

The issue of digital products has been discussed at Governing Board meetings and remains a controversial issue.

Recently, the SLAC has been looking to define “digital products” to include three specific defined products:

- digital audio-visual works
- digital audio works
- digital books

These products must be transferred electronically, be sold to a purchaser who has the right of permanent use granted by the seller which is not conditioned on continued payment from the purchaser, and be sold to a purchaser who is an end user. A member state must abide by the definitions in order to tax or exempt these products, however, a member state could still tax other similar products by enacting a special imposition.

Businesses are concerned about the ability of a state to tax a digital product that does not fall within this definition.

VIII. Impact on SC Businesses – Multistate vs. Local

Large multistate sellers will benefit from the Agreement with respect to the uniform definitions, reduced compliance costs, lower audit risk, and easier programming of cash registers and computer systems. Most issues raised regarding the Agreement focus on these large multi-state businesses.

However, the required changes in a state's law and its administration of its sales and use tax will affect all types of small and regional businesses, including but not limited to restaurants, bakeries, farmers, hotels, florists, and gas stations. Many of these businesses may only sell within South Carolina or only within the tri-state area of North Carolina, South Carolina and Georgia. Many may not be involved with Internet sales. Regardless, the Agreement will affect them as well as the large multistate sellers.

For example, the definition of the term "food and food ingredients," the prohibition on certain maximum tax provisions presently allowed in South Carolina, and prohibition of multiple state tax rates will affect such in-state businesses, entities and purchasers as grocers, convenience stores, sellers and purchasers of trailers, unassembled aircraft, non-motorized recreational vehicles, religious organizations, hotels and motels, and person 85 years of age and older.

In addition, some sellers may have to file multiple tax returns if new replacement taxes, such as a "lodging" tax, are enacted.

All of this will require an extensive education of taxpayers about the changes in the law.

IX. Impact on the General Assembly

Adoption of the Agreement will have direct impact on the General Assembly. The General Assembly will have to choose between expulsion from the Agreement or the loss of legislative flexibility in crafting various provisions of the sales and use tax law. Some current examples include:

- Exemptions applying to products defined in the Agreement must use the Agreement's definition and must exempt all items falling within the definition unless the Agreement allows an exception.
- Maximum tax items will be limited to the exceptions allowed in the Agreement. All other items must be taxed fully or exempted fully.
- Local sales and use tax must exempt the same items as the state sales and use tax. Local jurisdictions will no longer be able to exempt food while other local jurisdictions tax food.
- Effective dates for new local tax rates must be on a date allowed by the Agreement.

The above are just a few of the possible examples. The General may have to develop some sort of screening process as part of its legislative enactment process to ensure proposed sales and use tax legislation is in compliance with the Agreement.

X. Impact on the Department of Revenue

Adoption of the Agreement will require a significant education effort for employees of the changes in the law adopted by the state. In turn, the Department will need to educate local governments and South Carolina retailers.

Adoption of the Agreement will require the Department to address various issues from a technology (computer/systems) perspective, including four main systems:

- Registration
- Rates & Boundaries,
- Sales filing and payment, and
- Information Reporting

Registration: Registration is “streamlined,” in that, the Department would receive abbreviated information compared to the data the Department currently receives in its Business Tax Registration (“BTR”) system or plans to receive in the South Carolina Integrated Tax System (“SCITS”) it is developing. The Department will need to build a new registration system – or a sub-system within BTR/SCITS - to accept, store, and deal with this abbreviated set of data, while still keeping its full registration system for entities with other tax types or with nexus. From an operational standpoint, the Department’s registration unit will need to validate the streamlined registrations to determine whether full registration is in fact required for the taxpayer. From an audit standpoint, we will not have, for example, any data on owners or officers.

Rates & Boundaries: States are required to provide a database which assigns each physical address, at least to the zip+4 level, to its taxing jurisdictions, and then to cross-reference each jurisdiction to its tax rate(s). If this is not done, streamlined sellers can use any “reasonable” means to determine the jurisdiction of a mail order or Internet sale, and the local jurisdictions may or may not get all of the local sales and use taxes to which they are entitled. (For example, when a zip code crosses county boundaries.) This database will not be easy to construct since some counties still do not have complete GIS mapping. The Department may have to purchase or certify a database from a vendor, which will be a significant cost and still not be perfect. States have struggled with this.

Sales Filing & Payment: The current sales tax system in the Department system (known as SCATS – South Carolina Automated Tax System) has encoded South Carolina’s our current sales tax law. Therefore, to the extent the law is amended to comply with the Agreement in such areas as changing allowable deductions, eliminating caps, changing some calculations, then the system will have to be rewritten to accommodate the changes. The timing could create problem with SCITS, unless the decision to adopt the Agreement is made immediately, since Sales is one of the first systems planned to go live, in September 2008. SCITS resources are then

expected to be devoted to the remaining systems, such as Individual Income Tax (“IIT”) and Corporate Income Tax. If the Department has to implement the sales component of SCITS, and then turn around and re-implement because of adoption of the Agreement, it could extend SCITS by a year and several million dollars.

Additionally there are the differences between streamlined filing and regular filing – just as in Registration, the Department would have to build an alternative system to receive and process abbreviated streamlined returns as well as maintaining the system to receive full returns from non-streamlined sellers - unless the Department decided to collect less information from all taxpayers.

Information Reporting: Since the Agreement’s Simplified Electronic Return (SER) is in fact abbreviated, the Agreement allows states to require a semi-annual Information Report to gather the rest of the information. This means, for example, that a breakout of deductions and exemptions claimed would only be available every six months as well as the breakout by location for those bricks-and-mortar establishments which are eligible to file under streamlined. The Department will have to build a new sub-system within Sales Tax to receive and process the Information Returns, and to reconcile them to the SERs. This will impact how auditors do their jobs, and how the Data Warehouse is loaded and utilized for sales tax filers.

XI. Revenue implications

One of the major purposes of the Agreement is to ensure the state receives the proper tax revenue from sales involving out-of-state retailers such as Internet and mail order retailers and to promote a level playing field for South Carolina brick and mortar sellers who must compete with Internet and mail order retailers.⁷⁶ Having out-of-state retailers collecting and remitting the tax voluntarily by participating in the Agreement, or being required to participate pursuant to federal legislation (if enacted), will increase sales and use tax revenues.

The issue is how much of an impact would participating in the Agreement have on sales and use tax revenues.

In addressing this issue of the revenue impact of participating in the Agreement, there are several important points to consider:

- Unless federal legislation is enacted, the participation in the Agreement of retailers that do not have nexus with South Carolina is voluntary.

The fact that a state is a member state in the Agreement does not require a retailer to participate under the Agreement. The system created by the Agreement is voluntary. On the other hand, if a seller registers in one state, the seller must register in all state participating in the Agreement. However, as is the case now, if a seller has nexus with a state, the seller must collect and remit the tax to that state. As such, revenue will not be certain since there is no way to determine how many retailers and which retailers will participate.

- Retailers who voluntarily participate in the Agreement are eligible for amnesty.

If South Carolina were to adopt and come into compliance with the Agreement, amnesty would be available for 12 months for all sellers not presently registered for collecting and remitting the sales and use tax in South Carolina (provided the seller has not been notified of an audit and does not have an ongoing, unresolved audit). As such, prior liabilities of any seller who had nexus but was not registered with South Carolina will be lost. The seller is required to be registered and collecting and remitting the tax for 36 months in order for the amnesty to be fully effective.

- Retailers who have nexus with South Carolina at this time are already required to collect and remit the tax regardless of South Carolina's participation in the Agreement.

⁷⁶ See Exhibit E-2, "Do Internet Tax Policies Place Local Retailers at a Competitive Disadvantage?"

These retailers, if they are not registered with the Department, are liable for sales and use taxes with respect to past sales into South Carolina for the time period in which they have had nexus. The Department has, and continues to, bring into compliance out-of-state taxpayers who are doing business in South Carolina and who have the requisite nexus with South Carolina. See next bullet concerning the Department's "Nexus/Discovery Team."

- The Department's has had, and continues to have, significant success in registering Internet companies and other out-of-state taxpayers for collecting and remittance of the tax.

The Department's "Nexus/Discovery Team" was established to bring into compliance out-of-state taxpayers who are doing business in South Carolina and who have the requisite nexus with South Carolina.

Information concerning these non-filers is obtained through various methods, including but not limited to, Department database crosschecks, regional and national exchange programs, Internet research, and referrals by Department auditors.

The Nexus/Discovery Team also manages the Department's "Voluntary Disclosure Program" that allows taxpayers who have sufficient South Carolina "nexus," and have not registered with the Department to collect or remit South Carolina taxes. This voluntary disclosure program is designed to (1) encourage nonfilers to come forward voluntarily and begin paying taxes without incurring penalties and (2) allow the Department to maximize compliance with limited resources.

As a result of these programs, 20 of the top 25 e-retailers are registered with the Department and collecting and remitting sales and use taxes.

For fiscal years ending June 30, 2002 through June 30, 2006, this team has averaged 202 new registrants per year (all taxes, but primarily income and sales and use taxes) and \$7,300,000.00⁷⁷ in collections each year from these new registrants.

For the most recent fiscal year ending on June 30, 2007, the Nexus/Discovery Team registered 315 new taxpayers and collected \$14,526,596.00.⁷⁸

- The change in how traditional brick and mortar retailers operate their Internet sales operations.

⁷⁷ Collection revenue as shown in this average includes all back taxes collected from new registrants plus revenue generated in the first year by previous registrants.

⁷⁸ Collection revenue as shown includes all back taxes collected from new registrants plus revenue generated in the first year by previous registrants.

At one time, many “brick and mortar” retailers established “barriers” between their retail store operations and their Internet sales operations. This reduced the chances of nexus being established with the Internet operation. However, over the last several years, many of these businesses have eliminated these barriers (e.g., customers can return Internet purchases to a related “brick and mortar” store). Therefore, nexus is established with the Internet operation and more of these operations are registering and remitting taxes. As such, loss of revenue to Internet sales may not be as high as previously estimated.

This position is supported by a 2004 report by Forrester Research Inc. for the National Governor’s Association and the National Conference of State Legislatures (Attached as Exhibit “E”). The report, entitled *The Growth of Multichannel Retailing*, states that this method of business, whereby a “brick and mortar” taxpayer located in a state also sells via an Internet website, establishes the requirement for the collection and remittance of sales and use taxes for such sales made via the Internet. It also reports that multichannel retailing accounts for 75% of Internet sales.

The report states with respect to the collection of sales tax:

A site-by-site review of the top 100 retail sites reveals that the majority of retailers now also collect sales tax: Of those that sell online, 94% of the top retailers collect sales tax online in states in which they have nexus.

Finally, in the July 2004 update of one of the most widely quoted reports concerning the revenue loss from e-commerce,⁷⁹ the loss estimates were lowered with one explanation being the growth of multichannel retailing.⁸⁰

- The uncertainty of revenue loss estimates by published studies on revenue lost by states because of Internet sales.

See *State and Local Sales Tax Revenue Losses from E-Commerce: Estimates as of July 2004* by Dr. Donald Bruce and Dr. William F. Fox of the Center for Business and Economic Research at the University of Tennessee (“*Bruce and Fox Report*”) and *A Current Calculation of Uncollected Sales Tax Arising from Internet Growth* by Peter A. Johnson, Senior Economist for The Direct Marketing Association (“*DMA Report*”).

The following is information from the “*Bruce and Fox Report*” as to the authors’ estimated revenue losses from e-commerce as it relates to South Carolina:

⁷⁹ *State and Local Sales Tax Revenue Losses from E-Commerce: Estimates as of July 2004* by Dr. Donald Bruce and Dr. William F. Fox of the Center for Business and Economic Research at the University of Tennessee.

⁸⁰ The report, in a footnote, cites the example of firms merging their online and offline channels after initially seeking to separate the activities and references the report - *The Growth of Multichannel Retailing*.

Estimated State and Local Revenue Loss for 2003
\$179.4 million (low growth scenario)
\$186.9 million (high growth scenario)

Estimated State and Local Revenue Loss for 2008
\$252.3 million (low growth scenario)
\$394.5 million (high growth scenario)

Estimated State-Local Split of Revenue Loss for 2008
\$243.0 million state; \$9.3 million local (low growth scenario)
\$380.0 million state; \$14.5 million local (high growth scenario)

Estimated State Revenue Loss for 2008 as a Percentage of 2003 State Total
Tax Collections
3.8% (low growth scenario)
6.0% (high growth scenario)

The “DMA Report,” while it does not give a state by state breakdown of estimated revenue losses due to e-commerce, concludes the following:

Nationwide Estimate for Uncollected Sales Tax from the Internet
\$1.9 billion for 2001
\$4.5 billion for 2011

The author of the “DMA Report” notes in his executive summary that the \$4.5 billion revenue loss for 2011 is less than 10% of the amount projected by the 2001 “Bruce and Fox Report.”⁸¹

Finally, using the “*Bruce and Fox Report*” to determine South Carolina’s percentage of the nationwide revenue loss (based on the 2008 estimated numbers) and applying that South Carolina percentage to the nationwide estimate for uncollected sales tax from the Internet from the “*DMA Report*,” the South Carolina’s estimate for uncollected sales tax for 2011 from the Internet using the “*DMA Report*” as the basis for revenue loss would be \$52.65 million calculated as follows:

South Carolina: \$394.5 million (high growth scenario) for 2008
Nationwide: \$33,667.8 million (high growth scenario) for 2008
SC Percentage of Nationwide Loss: 1.17% ($\$394.5/\$33,667.8$)
SC Estimated Loss for 2011 Based on the DMA Report: \$52.65 million
($\$4.5 \text{ billion} \times 1.17\% = \52.65 million)

See Exhibits “F” and “G.”

⁸¹ The “Bruce and Fox Report” cited in this document and provided as an exhibit is the report from 2004.

- The uncertainty of the revenue in conforming to the Agreement.

Hundreds of decisions, both large and small, will have to be made by the General Assembly if it decides to conform the sales and use tax laws to the Agreement. As mentioned previously in this document, decisions will have to be made as to certain impositions, tax rates (raise, lower, or the creation of replacement taxes), exemptions (eliminate, expand or modify in some manner), and administrative provisions. The General Assembly may also have to balance changes that increase revenue against those that decrease revenue – an approach that may create “winners” and “losers” among taxpayers. While these changes can be designed in such a way to minimize the impact on revenue, the significant number of changes necessary will significantly increase the uncertainty of the ultimate revenue estimate.

- The costs associated with conforming to the Agreement.

There will be new costs to the state if it conforms the sales and use tax law to the Agreement. The Agreement requires the adoption of new technologies (e.g., participating in the central registration system, accepting the simplified electronic return, developing the rate and address databases), extensive systems programming and processing changes by the Department, compensation member states provide Certified Service Providers (this compensation ranges from 2 to 8 percent of tax collected from sellers that do not have nexus with the state), and the annual membership fees for membership in the Governing Board.⁸²

- While one of the goals of the Agreement is simplification, the changes will not be simple for local businesses.

While the Agreement simplifies collecting and reporting of the tax by establishing the same rules for many states, the rules themselves are not simple. The many product definitions and the possibilities of replacement taxes to replace lost revenue create complexity that may affect compliance and therefore revenue. There will be a significant “learning curve” for local retailers.

- Sales and use tax policy influences the behavior of the consumer and retailers.

In a report entitled “Do Internet Tax Policies Place Local Retailers at a Competitive Disadvantage?” dated November 2006 (See Exhibit E-2), the authors⁸³ discuss how “[t]he relationship between tax policy and retail competition is clearly an important component of Internet tax policy debate.

Quoting from the report: “The key contribution of this paper is to provide rigorous empirical evidence that current tax laws on nexus reduce consumer

⁸² See Section IV, F.1 – “Collection and Service Providers.”

⁸³ The authors of this report are: Eric T. Anderson of the Kellogg Graduate School of Management and Nathan M. Fong, Duncan I. Simester and Catherine E. Tucker, all of the MIT Sloan School of Management.

demand and distort the expansion decisions of firms. Policy makers and retailers who support new legislation have argued that the playing field is not level. Our empirical results speak directly to how tax policy affects retail competition and the extent to which the playing field is not level. Current tax policy reduced consumer demand for the firm that we study. We speculate that at least some of this lost demand represents a gain for a competing retailer. Our results also show that the current tax policy is affecting retail competition in states with high sales tax. Our results show that fewer stores were opened in high tax states, which may have reduced competition between physical stores in these states.”

XII. Conclusion

The Governing Board is now responsible for the governing and administration of the Agreement. As part of the administration, the Governing Board is continuing its effort to “refine” the Agreement as evidenced by the 9 amendments to the Agreement since it was first finalized in 2002.

Simplification is one of the major purposes of the Agreement. There are aspects of the Agreement that provide simplification – for example the provisions concerning identical state and local tax bases and a single state tax rate. Such changes, of course, would be helpful whether or not they are done as part of any agreement. However, there are aspects of the Agreement that are complex. Most of these complex provisions concern definitions and the interpretation of such definitions. Of course, the current South Carolina sales and use tax law contains some complexities, but the taxpayers of our state are more experienced in dealing with these provisions. In addition, some states have complicated the process for in-state taxpayers and other taxpayers with nexus by creating replacement taxes – a choice that South Carolina may also have to make if it decides to participate.

Also, if South Carolina decides to adopt the Agreement, transforming the state and local sales and use tax laws of South Carolina will not be a simple task – whether that task is in the technical drafting of the law, the policy and political decisions that will have to be made, the possible creation of new “replacement” taxes, the education of Department of Revenue employees and taxpayers and their employees, or the technical changes and associated costs to computer systems and software.

The changes in the industry toward multichannel retailing, the efforts of the Department’s Nexus/Discovery Team and auditors, and the Department’s participation in regional and national information exchange agreements have all assisted in registering more and more out-of-state retailers. While large Internet-only retailers cannot be compelled to register in South Carolina due to a lack of nexus, our participation in the Agreement may not change that since participation by retailers is voluntary. Only Congressional action can require retailers to register in states with which they do not have nexus.

The General Assembly would, as a practical matter, lose a significant amount of legislative autonomy and flexibility as a trade-off for enacting the law changes that would be required under the Agreement.

Finally, most states participated in the Streamlined Sales Tax Project, but only 15⁸⁴ have adopted the provisions required to become full members under the Agreement and some states that were moving toward full membership (e.g., Ohio and Utah) are reconsidering

⁸⁴ The number of full member states will increase in the near future. Associate member state Washington will become a full member effective January 1, 2008. Associate member states Arkansas and Wyoming have filed petitions for full member state status effective January 1, 2008. However, Utah and Ohio may lose associate member status January 1, 2008 and Tennessee has enacted conforming legislation effective July 1, 2009.

their commitment to amend their laws to adopt all of the required provisions of the Agreement.

Ultimately, the General Assembly must weigh the potential for increased revenue that may be used to provide services or additional tax relief against the complexities of the Agreement and the effective loss of sovereignty to the Governing Board. Regardless, simplification of the South Carolina sales and use tax is a worthy goal and may be an effort that the General Assembly may want to consider even if South Carolina does not adopt the Agreement.

If the decision is made not to join at this time, but to consider joining at some time in the future (perhaps if the federal legislation is enacted that allows member states to collect sales and use taxes from retailers without physical presence), then the General Assembly may wish to consider:

- Reviewing the Agreement to determine if any of its provisions should be adopted to improve South Carolina's sales and use tax law without any consideration of joining the Agreement.⁸⁵
- Requiring sponsors of future amendments to South Carolina's sales and use tax law to inform the House Ways and Means Committee and the Senate Finance Committee how the proposed legislation would bring South Carolina law closer to, or farther from, the Agreement's model. This information would not be to prevent the adoption of legislation that moves South Carolina farther from the Agreement's model; it would be merely intended to inform the members of the General Assembly of the consequences of the legislation if the General Assembly were to decide, at sometime in the future, to join the Agreement.

⁸⁵ For example, South Carolina presently taxes software (prewritten and custom) when delivered in tangible form and does not tax software (prewritten and custom) when delivered electronically. See SC Revenue Ruling #05-13. The Agreement includes prewritten software within the definition of "tangible personal property;" therefore, prewritten software, whether delivered in tangible form or electronically, would be subject to the tax unless the General Assembly exempts it (the Agreement allows the exemption of all prewritten software or a limited exemption for prewritten software that is delivered electronically). Custom software would not be taxed under the Agreement unless the General Assembly imposed the tax on the service of creating and selling custom software. . In this example, the Agreement treats prewritten software as a product and custom software as a service and taxes prewritten software regardless of how it is transferred (tangible form or electronically). The General Assembly may decide (1) that the Agreement's perspective is the proper policy perspective for South Carolina, (2) that both prewritten and custom software are products and should be taxed regardless of how they are transferred, or (3) that it isn't prudent to change settled expectations (current policy) and that both prewritten and custom software are products and should be taxed, but only if transferred in tangible form.

XII. Exhibits

- A. Streamlined Sales and Use Tax Agreement
- B. Governing Board Rules
- C. Governing Board Taxability Matrix
- D. Governing Board Certificate of Compliance
- E-1. “The Growth of Multichannel Retailing” - Forrester Research, Inc Report
- E-2. “Do Internet Tax Policies Place Local Retailers at a Competitive Disadvantage?” by Eric T. Anderson of the Kellogg Graduate School of Management and Nathan M. Fong, Duncan I. Simester and Catherine E. Tucker, all of the MIT Sloan School of Management.
- F. “State and Local Sales Tax Revenue Losses from E-Commerce: Estimates as of July 2004” by Dr. Donald Bruce and Dr. William F. Fox
- G. “A Current Calculation of Uncollected Sales Tax Arising from Internet Growth” by Peter A. Johnson
- H. Proposed Federal Legislation
- I. SC Information Letter #07-4
- J. SC Revenue Ruling #05-9
- K. SC Information Letter #05-13
- L. SC Revenue Rulings #05-16 and #91-17
- M. SC Revenue Ruling #06-2
- N. South Carolina Counties by Zip Code - Form ST-439
- O. Exemptions and Exclusions Chapter - SC Sales and Use Tax Workshop Manual-2007

Exhibit A

Streamlined Sales and Use Tax Agreement
As Adopted November 12, 2002 and
As Last Amended on June 23, 2007

Exhibit B

Rules and Procedures of the Streamlined Sales Tax Governing Board, Inc.
As Approved October 1, 2005 an As Last Amended June 23, 2007

and

Bylaws of the Streamlined Sales Tax Governing Board, Inc.
AS Last Amended June 23, 2007

Exhibit C

Governing Board Taxability Matrix

(This matrix must be completed by any state that adopts the Agreement as part of the “application process” to join the Governing Board. The matrix sets forth whether the sale of a specific item is taxable or exempt under the state’s sales and use tax law.)

Exhibit D

Governing Board Certificate of Compliance

(This certificate must be completed by any state that adopts the Agreement as part of the “application process” to join the Governing Board. The state must answer specific questions so that it may be determined if the state is in compliance with the Agreement.)

Exhibit E-1

The Growth of Multichannel Retailing
Forrester Research, Inc Report
Prepared for National Governor's Association
and National Conference of State Legislatures

Exhibit E-2

“Do Internet Tax Policies Place Local Retailers at a Competitive
Disadvantage?”

by

Eric T. Anderson of the Kellogg Graduate School of Management and
Nathan M. Fong, Duncan I. Simester and Catherine E. Tucker, all of the
MIT Sloan School of Management.

Exhibit F

State and Local Sales Tax Revenue Losses from E-Commerce: Estimates as of July 2004 by Dr. Donald Bruce and Dr. William F. Fox of the Center for Business and Economic Research at the University of Tennessee

Exhibit G

A Current Calculation of Uncollected Sales Tax Arising from Internet Growth by Peter A. Johnson, Senior Economist for The Direct Marketing Association

Exhibit H

Proposed Federal Legislation Introduced in Congress
Sales Tax Fairness and Simplification Act
(Senate Bill 34 introduced on May 22, 2007 and the companion
House Bill 3396 introduced on August 3, 2007)

Exhibit I

SC Information Letter #07-4

(This information letter provides a chart of counties imposing a local sales and use tax and the type of local sales and use tax imposed in each county, as of the date of this report. It also includes a discussion of the exemption applicable to each local sales and use tax.)

Exhibit J

SC Revenue Ruling #05-9

(This advisory opinion provides examples of items exempt and not exempt during the State's annual sales tax holiday.)

Exhibit K

SC Information Letter #05-13

(This information letter explains the application of the sales and use tax to sales of motor vehicles, trailers, semitrailers, and pole trailers to nonresidents.)

Exhibit L

SC Revenue Ruling #05-16
and
SC Revenue Ruling #91-17

(These advisory opinions provide guidance as to the application of local sales and use taxes and the remittance responsibilities of retailers.)

Exhibit M

SC Revenue Ruling #06-2

(This advisory opinion addresses several questions concerning the use tax and the purchaser's responsibility for remitting the tax when not collected and remitted by the retailer.)

Exhibit N

South Carolina Counties by Zip Code
Form ST-439

(This form lists the total state and local sales and use tax by zip code for each county. The zip codes are listed in numerical order.)

Exhibit O

Exemptions and Exclusions Chapter of South Carolina Sales and Use Tax Workshop Manual – 2007

(This exhibit provides a listing of the various exemptions
and exclusions from the sales and use tax.)