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STREAMLINED SALES TAX PROJECT SSUTA AGREEMENT SECTION ANALYSIS

STATE OF CALIFORNIA BOARD OF GOVERNANCE

Section: 326 (Exhibit I provides the language of Section 326 of the Streamlined Sales and Use Tax Agreement (SSUTA))

Title: Direct Pay Permits

Summary

SSUTA Section 326 requires that member states provide authority for the issuance of a “direct pay permit” to allow permit holders to purchase taxable goods and services without the payment of tax or tax reimbursement to the vendor from whom the purchase is made. California currently has statutory authority for the issuance of a “retailers; direct payment permit” and a “use tax direct payment permit” that would generally satisfy the provisions of SSUTA Section 326 (Revenue and Taxation Code sections (Section) 7051.1, 7051.2 and 7051.3). Although the provisions of California’s Sections may differ from that of SSUTA Section 326, they otherwise appear to be in substantial compliance with the provisions of SSUTA Section 326.

Conforming to SSUTA Section 326 would not require the enactment of statutes beyond what California currently provides; however, if the current limits placed on the issuance of California’s direct payment permits were considered too restrictive by the SSUTA governing board, conformance would require amendments to California’s applicable statutes and/or regulations. The current use tax direct payment permit application form may also require revision or discontinuance.

Description

As provided by SSUTA Section 326, in order to adopt and conform to the SSUTA, states are required to provide authority for the issuance of direct payment permits to qualifying persons to purchase taxable goods or services without the payment of tax to the seller. Permit holders must determine the taxability of their purchases, report and remit payment of the applicable taxes directly to the taxing agency, and source the purchases to the appropriate taxing jurisdictions. The direct pay authority is applicable to both sales tax and use tax transactions.

SSUTA Section 326 also provides that member states may set their own limits and requirements (i.e., type of eligible businesses, criteria for determining eligibility, type of eligible transactions, etc.) for the

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issuance of a direct payment permit. Under the provisions of SSUTA Section 326, the SSUTA governing board shall advise member states regarding the limits and requirements the state will set. Although Section 326 does not specifically discuss the level of the governing board’s involvement in the limits and requirements set by a state, such involvement is currently understood to be in the nature of guidance.

SSUTA Section 326 further provides that the governing board, in advising member states, shall consider the use of the Model Direct Payment Permit Regulation (Model Regulation) developed by the Task Force on EDI Audit and Legal Issues for Tax Administration (Task Force) for the Multistate Tax Commission (MTC). Except for the monetary limitations, the Model Regulation adopted by the MTC includes qualification, record-keeping, and reporting requirements comparable to those required under the Board’s current direct payment permit statutes and/or regulations. However, the Model Regulation may not follow the general sourcing rules of the SSUTA since the tax rate applicable to the permit holders’ purchases is the rate imposed by the jurisdiction in which the first taxable use occurs rather than the rate imposed where the property is received. (Exhibit II provides the language of the Model Regulation.)

Related SSUTA Sections

- Section 312: Multiple Points of Use
- Section 313: Direct Mail Sourcing
- Section 317: Administration of Exemptions

Related California Sections and Code of Regulations, Title 18 Sections (Regulation)

- Section 7051.1 Retailers; direct payment permit
- Section 7051.2 Retailers; direct payment permit
- Section 7051.3 Use tax direct payment permit
- Regulation 1684 Collection of Use Tax by Retailers
- Regulation 1685 Payment of Tax by Purchasers
- Regulation 1699.5 Direct Payment Permits
- Regulation 1699.6 Use Tax Direct Payment Permits
- Regulation 1703 Interest and Penalties
- Regulation 1827 Collection of Use Tax by Retailers

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Evaluation

Retailers; Direct Payment Permit – California Statutory Authority

Under the provisions of Section 7051.1, the Board of Equalization (Board) has authority to adopt rules and regulations governing the issuance of a direct payment permit to persons who hold a valid California seller's permit. The direct payment permit allows the permit holder to purchase tangible personal property for use without the payment of sales tax reimbursement to the retailer and also relieves the retailer of the liability for the sales tax imposed on the transaction when certain statutory conditions are met. Direct payment permits are issued only when it can be shown that issuing the permit will facilitate the collection and allocation of the taxes imposed to the mutual convenience of all and will not result in a tax loss to the state in total or on a cash flow basis.

Persons issued a direct payment permit are required to include with each tax return a schedule upon which the local taxes and applicable district taxes due on the retailer's transaction will be allocated. The permit holder is required to source the taxes to the same jurisdictions that would have received the tax revenue if the taxes had been reported and paid by the retailer. The permit holder is also required to schedule and source any use tax liabilities that may apply to their purchase or use of tangible personal property, including those the retailer may be obligated to collect.

As authorized by Section 7051.2, persons holding a valid direct payment permit may issue an exemption certificate to the retailer for the purpose of paying that retailer's tax liability directly to the Board. When a direct payment permit holder gives an exemption certificate to a retailer, the permit holder is liable for the payment of the retailer's tax liability on a timely basis and is subject to the same penalty provisions that would apply if the permit holder were the retailer. If the permit holder does not properly source the retailer's local and applicable district taxes, the permit holder is liable for a penalty of ten percent of the retailer's tax liability when such improper allocation is due to negligence or intentional disregard of the law. As of April 2005, no retailers direct payment permits have been issued.

Reference: Sections 7051.1 and 7051.2; Sales and Use Tax Department, *Use Tax Direct Payment Permit Data Base*

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Use Tax Direct Payment Permit – California Statutory Authority

Effective January 1, 1998, the Board was provided statutory authority to accept applications for a use tax direct payment permit and to issue a permit when the applicant meets certain conditions. An application for a use tax direct payment permit must be made upon a form prescribed by the Board and must contain specific information required by the Board. Persons who submit an application must certify they are the purchaser for their own use or lessee of tangible personal property subject to the use tax at a cost of five hundred thousand dollars (\$500,000) or more in aggregate during the calendar year immediately preceding the application. Or, the person must be a county, city, city and county, or redevelopment agency. As of April 2005, the Board has issued use tax direct payment permits to forty-four (44) companies and ninety-two (92) local taxing jurisdictions.

Holders of a use tax direct payment permit agree to self-assess and report the use taxes due on their purchases and leases directly to the Board rather than paying the use tax to the retailers or sellers who are registered to collect the tax on the Board's behalf. As an alternative to use tax revenues distributed through the pooling process, revenues are sourced to the jurisdiction where the first use of the property occurs (as defined by Section 6009), which assures local use taxes are sourced fully to the jurisdictions where the purchaser will actually use the property.

Persons who hold a use tax direct payment permit are allowed to issue a use tax direct payment certificate to the registered retailer or seller as long as the certificate is in a form prescribed by the Board and contains the required information, including the permit number. A use tax direct payment certificate relieves the retailer or seller who sold the property from the duty of collecting the use tax when taken in good faith. When a certificate is taken in good faith, the purchaser is the sole person liable for any sales tax and related interest and penalties with respect to any transaction subsequently determined to be subject to sales tax, not use tax. A purchaser who issues a use tax direct payment certificate shall also be subject to the same penalty provisions that apply to the retailer or seller.

Reference: Section 7051.3, Publication 28, *Tax Information for City and County Officials*; Sales and Use Tax Department, *Use Tax Direct Payment Permit Data Base*

MTC Model Regulation

According to the Task Force's Steering Committee report (A Report of the Steering Committee; *Task Force on EDI Audit and Legal Issues for Tax Administration*; June 2000), the Model Regulation was

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developed to provide a document states could follow when implementing or expanding a direct pay program. The purpose of the Model Regulation is to define the requirements imposed on taxpayers seeking direct payment status, and to focus on the business needs of taxpayers in determining whether direct pay authority should be granted rather than relying on the traditional requirements currently in place in many states.

Other than California's monetary restrictions and the use of an exemption certificate and the Model Regulation's exclusion of certain types of purchases, the requirements and definitions in the Model Regulation are comparable to the requirements and definitions contained within the Board's direct payment permit regulations: Regulation 1699.5 and Regulation 1699.6.

- **California's Monetary Restrictions**

Although Regulation 1699.5 (direct payment permit) and Section 7051.3 and Regulation 1699.6 (use tax direct payment permit) place monetary restrictions on the transactions of persons applying for a direct payment permit or use tax direct payment permit, neither SSUTA Section 326 nor the Model Regulation includes such limitations. Under Regulation 1699.5, the issuance of a direct payment permit is not deemed to be to the mutual convenience of all if the applicant is a governmental entity; or if the applicant had gross receipts from sales of tangible personal property of less than \$75,000,000 *and* purchases subject to sales or use tax of less than \$75,000,000, in any calendar quarter during the twelve months immediately preceding the application for a permit.

As provided by Section 7051.3 and Regulation 1699.6, applicants for a use tax direct payment permit other than a city, county, city and county, or a redevelopment agency are required to certify that their purchases or leases of tangible personal property subject to the use tax were \$500,000 or more in total during the calendar year immediately preceding the application for a use tax direct payment permit. Applicants meeting the monetary requirement are generally issued a permit assuming the other regulatory requirements are met.

- **Use of Exemption Certificates**

Under the Model Regulation, the holder of a direct payment permit is required to furnish a copy of their permit *or* other acceptable evidence (if allowed by a state's statute) that the permit holder has been granted a direct payment permit, including the number of the permit and the date issued, to each vendor from whom the holder purchases tangible personal property or services. Persons who

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hold a direct payment permit are not required to issue a separate exemption certificate. Receipt of a copy of the direct payment permit or other acceptable evidence that the person holds a permit, relieves the vendor of the responsibility of collecting the taxes due on qualifying transactions between the vendor and the direct payment permit holder.

In contrast, Regulation 1699.5 provides that holders of a direct payment permit may issue a direct payment exemption certificate to any retailer. The certificate should be in substantially the same form as that provided in the regulation and is valid only with respect to the calendar year for which it is issued. When a retailer timely takes a direct payment exemption certificate in good faith, the retailer is relieved from liability for the sales tax and responsibility for collecting the use tax with respect to their retail sales to the person who issued the certificate during the period covered by the certificate.

Regulation 1699.6 provides that the holder of a use tax direct payment permit is allowed to issue a use tax direct payment exemption certificate to any registered retailer or seller as long as the certificate is in a form prescribed by the Board and bears the name, address, and permit number of the holder. The certificate remains in effect until revised or withdrawn by the permit holder or until the retailer or seller has received written notice that the Board revoked the permit. Accepting a use tax direct payment certificate timely and in good faith relieves the person selling the property from the duty of collecting use tax from the permit holder.

We note that the Streamlined Sales Tax Project is in the process of developing a multi-state exemption certificate that can be issued by the purchaser and will relieve the retailer or seller of the liability for, or obligation to collect the taxes due on the transaction. The certificate requires the same type of information required by the certificates in Regulations 1699.5 and 1699.6, including the purchaser's tax identification number or other such governmental license numbers (i.e., driver's license or Federal Employer Identification Number). The multi-state exemption certificate lists various types of exemptions, including an exemption for direct pay transactions, which the purchaser would identify when issuing the certificate. The certificate would be signed by the appropriate party (when presented in a tangible format) and would be treated the same as other types of exemption certificates.

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- **Model Regulation Excluded Transactions**

The Model Regulation provides that the holder of a direct payment permit shall not use the permit in connection with certain transactions. For example, a direct payment permit should not be used by the holder when purchasing meals and beverages; lodging; admission to places of amusement, entertainment, and other events; motor vehicles or other property required to be licensed; and services such as telecommunication services.

California's statutes and regulations, on the other hand, do not impose limitations on the type of tangible personal property that may be purchased by a permit holder once the person qualifies for a direct payment permit. California does, however, restrict the use of its' direct payment permit to purchases that will be used by the permit holder and those transactions where the retailer is liable for the tax. The use tax direct payment permit is restricted to transactions subject to the use tax.

Reference: MTC; Adopted Regulations, Statutes, and Guidelines (www.mtc.gov/); Federation of Tax Administrators, Research Reports (www.taxadmin.org/fta/ftapub.html)

Impact

Whether conforming to SSUTA Section 326 would have an impact on California would depend on whether the SSUTA governing board considers California's statutory authority for the issuance of direct payment permits too restrictive. If so, in order to be in substantial compliance, California would be required to amend its current statutory and/or regulatory requirements.

Section 326: DIRECT PAY PERMITS

Each member state shall provide for a direct pay authority that allows the holder of a direct pay permit to purchase otherwise taxable goods and services without payment of tax to the supplier at the time of purchase. The holder of the direct pay permit will make a determination of the taxability and then report and pay the applicable tax due directly to the tax jurisdiction. Each state can set its own limits and requirements for the direct pay permit. The governing board shall advise member states when setting state direct pay limits and requirements, and shall consider use of the Model Direct Payment Permit Regulation as developed by the Task Force on EDI Audit and Legal Issues for Tax Administration.

MULTISTATE TAX COMMISSION

MODEL DIRECT PAYMENT PERMIT REGULATION

Adopted July 28, 2000

A. "Direct payment permit" means a permit issued by [taxing authority] that allows a holder of such permit to accrue and pay state and local taxes under [statute] directly to the [taxing authority].

B. Application for Permit. Applicants for a direct payment permit must apply in writing to the [chief tax administrator]. The application shall be on a form required by the [chief tax administrator] or in a letter containing the applicant's name, address, the location of the place or places of business for which the applicant intends to make direct payment of tax, the sales and use tax account number(s) for which direct payment will be made, and any other information that the [taxing authority] may require.

C. Qualification Process and Requirements.

- (1) Applicants for a direct payment permit shall demonstrate the applicant's ability to comply with the [taxing authority] sales and use tax laws and reporting and payment requirements. The applicant must provide a description of the accounting system(s) which will be used by the applicant and demonstrate that the accounting system(s) will reflect the proper amount of tax due.
- (2) Applicants must establish a business purpose for seeking a direct payment permit and must demonstrate how direct payment will benefit tax compliance. For example, the utilization of direct payment authority should accomplish one or more of the following:
 - (a) Reduce the administrative work of determining taxability; collecting, verifying, calculating and/or remitting the tax;
 - (b) Provide for improved compliance with the tax laws of the [taxing jurisdiction];
 - (c) Provide for accurate compliance in circumstances where determination of taxability of the item is difficult or impractical at the time of purchase;
 - (d) Provide for more accurate calculation of the tax where new or electronic business processes such as electronic data interchange, evaluated receipts settlement, or procurement cards are utilized;

(e) Provide for more accurate determination and calculation of tax where significant automation and/or centralization of purchasing and/or accounting processes have occurred and applicant must comply with the laws and regulations of multiple state and local jurisdictions.

(3) The [chief tax administrator] or his/her designee shall review all permit applications. The review of applications shall be conducted in a timely manner so that applicants receive notification of authorization or denial within [30-120] days of the date the [chief tax administrator] or designee receives the application; however if additional documentation or discussion is required, the [chief tax administrator] or designee shall notify the taxpayer or, at taxpayer's request, schedule a conference with the applicant prior to the end of the [30-120]-day period.

D. Recordkeeping Requirements. A direct payment permit holder shall maintain all records that are necessary to a determination of the correct tax liability under [insert appropriate citations to state tax statutes]. All required records must be made available on request by the [taxing authority] or its authorized representatives as provided for in [insert appropriate citations to state tax statutes]. [Insert elements of state law which require certain records to be retained (e.g., books of account, invoices, sales receipts), or specific tax elements or transactions (e.g., credits) for which particular records may be required.]

E. Reporting of Tax. Each holder of a valid direct payment permit shall, on a form approved by the [taxing authority], accrue and pay directly to the [taxing authority] the taxes due under [statute] for all transactions subject to tax for which a direct payment permit applies. Taxes for which the direct payment permit is used shall be considered due and payable on the sales and use tax return next due following the date on which a determination of taxability is, or in the exercise of reasonable care should be, made for a given transaction, unless otherwise provided by written agreement between the taxpayer and the [taxing authority].

F. Certain Transactions Not Permitted. A holder of a direct pay permit shall not use such permit in connection with the following transactions:

- (1) purchases of taxable meals or beverages;
- (2) purchases of taxable lodging or services related thereto;

- (3) purchases of admissions to places of amusement, entertainment or athletic events, or the privilege of use of amusement devices;
- (4) purchases of motor vehicles, or other tangible personal property required to be licensed or titled with a taxing authority, taxed under [taxing authority] statutes [list applicable sections];
- (5) purchases of any of the following enumerated services listed in [tax authority] statutes. [List applicable sections. May include services such as telecommunications and utilities.]; and
- (6) Such other purchases as may be agreed to between the holder of the direct payment permit and the [taxing authority].

G. Permit Holder's Duties. The holder of a direct payment permit shall furnish a copy of the direct payment permit or other acceptable evidence, if allowed by statute, that the holder has been granted a direct payment permit, including the number of the permit and the date issued, to each vendor from whom the holder purchases tangible personal property or services. Persons who hold a direct payment permit shall not be required to issue a separate exemption certificate and shall not be required to pay the tax as prescribed in [state taxing statutes related to billing of sales or use tax by vendor].

The holder of a direct payment permit shall have responsibility for accruing and paying tax directly to [taxing authority] on all taxable transactions not taxed at the time of sale. In certain circumstances, it may be necessary for the permit holder to pay tax directly to the vendor. Where tax is paid directly to the vendor and [taxing authority] and permit holder agree, the holder may maintain accounting records in sufficient detail to show in summary, and in respect to each transaction, the amount of sales or use taxes paid to vendors in each reporting period.

H. Vendor's Responsibilities. Receipt of the direct payment permit or other acceptable evidence that the holder has been granted a direct payment permit, shall relieve the vendor of the responsibility of collecting the sales tax on sales made to a direct payment permit holder on qualifying transactions. Vendors and sellers who make sales upon which the tax is not collected by reason of the provisions of this section shall maintain records in such manner that the amount involved and identity of the purchaser may be ascertained. Receipts from such sales shall not be subject to the tax levied in [state taxing statutes related to billing of sales or use tax by vendor].

I. Local Taxes [if imposed]. A direct pay permit holder that makes taxable purchases of tangible personal property or services shall report and pay applicable local sales or use tax on those purchases. The local sales or use tax shall be calculated at the rate imposed by the jurisdiction in which the first taxable use occurs.

J. Revocation of Permit. A direct payment permit is not transferable, and the use of a direct pay permit may not be assigned to a third party. Direct payment permits may be revoked by the [chief tax administrator] at any time whenever the [chief tax administrator] determines that the person holding the permit has not complied with the provisions of this regulation or that the revocation would be in the best interests of the [taxing authority]. Such revocation shall follow the administrative procedures as provided for in [insert appropriate citations to state tax statutes].