

Streamlined Sales Tax Mitigation
Advisory Committee Meeting Minutes
August 26, 2009

Attendees:

Lorrie Brown, Office of Financial Management
Dean Carlson, Senate Ways & Means
Shelley Coleman, City of Auburn
Shawn Hunstock, City of Tukwila
Karen Jester, City of Auburn
Jim Justin, Association of Washington Cities
Jim Katica, City of Woodinville
Neil Kruse, City of Kirkland
Danielle Larson, City of Tacoma
Glen Lee, City of Seattle
Lucy Liu, City of Bellevue
Bob Nachlinger, City of Kent
Rick Peterson, House Finance
Donna Pethick, Pierce County
Kristie Vessey, Thurston County

Department of Revenue Staff - Kim Davis, Don Gutmann, Jim Harden, Tiffany Johnson, Diane Mielke, Valerie Torres, Cheryl Wack

ISSUE PAPERS

Don Gutmann: We want to go through the issue papers one more time and get your recommendations.

Valerie Torres: All four issues were identified when businesses brought them forward. They are generalized issues that keep coming up.

Businesses with Minimal Deliveries

Valerie Torres: Minimal deliveries have to do with businesses that have several storefronts in different cities. They don't actually make as many deliveries as we see in the gains or losses.

Don Gutmann: This is like Safeway or Starbucks stores that have multiple stores across the state. We are seeing large gains or losses when we do the mitigation calculations, but when we contact the taxpayers we are being told that they don't do a lot of deliveries.

Valerie Torres: Currently we have been doing the same review process with all the businesses – we contact them and find out if they do deliveries. It has been on a case by case, business by business basis.

A possible solution is to remove the businesses, or we can leave them in the mitigation calculation. However, if we leave them in we will have to go back, review the businesses, and put back in the businesses that we took out.

Bob Nachlinger: If I had a storefront that was actually a delivery warehouse and they turned around and made a number of deliveries to other jurisdictions through their Internet site, I am concerned about the magnitude of the change. If you remove such a business from the calculation, do you notify all the jurisdictions?

Valerie Torres: You now receive a file showing the businesses that have been removed.

Lorrie Brown: If it is a franchise, do you remove all the stores?

Valerie Torres: If we can find them. We try, but a lot of times jurisdictions tell us we know this is also a Safeway or also a Starbucks.

Lucy Liu: Have these impacts been minimal?

Valerie Torres: We have been very tight on what is minimal. If the business tells us it is a warehouse, I would probably leave it in.

Kim Davis: That is another reason why we haven't come up with a dollar amount threshold. What isn't a large dollar amount for Kent probably would be a large dollar amount for Entiat.

Don Gutmann: Is it okay for us to remove these businesses?

Bob Nachlinger: I have a problem with you taking the business out and then notifying me. If you tell me you are going to remove this firm and I have a chance to review it and let you know, then you could correct it on the next payment.

Donna Pethick: I personally talked to Pizza Hut in our county and they said their deliveries stop in the county, so I feel comfortable with that.

Don Gutmann: We are only going to make these types of adjustments until we annualize. After that it will only be once a year. This will be the last quarter we will inform you of the businesses that we are removing from your jurisdiction. Then you will have months to review the firms.

Valerie Torres: Part of the annualization process is to send one more set of files to show you which businesses are in or out.

Bob Nachlinger: If it is only ten firms that you are taking out and it's one percent of our total, I am okay with that.

Valerie Torres: The committee recommendation is number one: Remove businesses with minimal deliveries brought forward by local jurisdictions after being reviewed by the Department of Revenue and verified to have minimal deliveries. Also remove any businesses

found and verified by the Department of Revenue during the normal reviews of businesses conducted during the true-up period.

Direct Selling Organizations

Valerie Torres: Several of these were brought forward by jurisdictions. They are firms that make direct sales to persons in their homes such as Avon, Amway. Many of these businesses are not necessarily located in our state. They sell the products to the distributor. They were reporting the sales tax to the location of the party before the change to destination-based sales tax. The impact from these is relatively small. The Department has reached an agreement with many of these businesses on how they report their taxes. Others we don't have agreements with. Our current solution is if a jurisdiction contacts us, we contact the business and find out if it was destination-based before and, when appropriate, we remove it.

Bob Nachlinger: If an out-of-state seller is removed, does that mean that the voluntary compliance dollars that they might have generated would also be removed?

Lorrie Brown: They have nexus so they wouldn't be counted as voluntary compliers.

Don Gutmann: The committee recommendation is number one with contact from the Department of Revenue and continued notification to the jurisdictions when we remove a business.

Number one is: Review the direct selling organizations having agreements with the Department of Revenue. Any which do not appear to have been impacted by the change to destination-based sales tax would be removed from the mitigation calculation. Those direct selling/multi-level organizations without agreements with the Department of Revenue would be reviewed if brought forward by a jurisdiction.

Out-of-state Businesses

Valerie Torres: Out-of-state businesses have always paid taxes based on the destination – they haven't changed. But they don't have a physical presence in our state. They have some representation but not a physical presence.

Don Gutmann: Over the years we have reached agreements with some businesses to collect the taxes.

Lucy Liu: They would be in here?

Valerie Torres: Yes, they would be.

Lucy Liu: But destination-based would not change things for them.

Valerie Torres: They have always reported as destination-based. We have been reviewing these on a case by case basis. If they open a business in the state they are supposed to tell us, but they

don't always do that. So we didn't feel we could take all of these out of the calculation. We review them to find out that they have always paid tax as a destination-based business and then we remove them.

Don Gutmann: In some cases we can identify that they are out of state but have opened a storefront in Washington.

We have not completed a review of the top 117 businesses in this category. We wanted to get the recommendation from the committee before we did that. We need to do this to have it in the next quarter calculation.

Bob Nachlinger: If the top 117 businesses are 50 percent of the taxable retail sales, what is the dollar value of total retail sales for this group?

Valerie Torres: I can tell you after lunch. I know it is under \$100 million statewide.

Donna Pethick: My ongoing concern doesn't get answered by this. We have no guarantee that the businesses are reporting accurately. They don't always report to the right jurisdiction.

Bob Nachlinger: If you have a positive jurisdiction and if you pull a firm out and make the adjustment for the four quarters, what happens if their payment goes down?

Don Gutmann: This could cause a jurisdiction that hadn't received a payment to receive a payment.

Lorrie Brown: But it is not likely that it would be a big amount of money in any jurisdiction.

Don Gutmann: The only way we would become aware of this situation would be from a jurisdiction. We will hold off on a recommendation until we get the information from Valerie.

Motor Vehicles, Watercraft, and Manufactured Homes

Valerie Torres: This issue was brought forward by jurisdictions who didn't feel that these businesses did deliveries. For some of these, a piece of their business was deliveries. The car sales are still origin-based. But the parts and accessories are destination-based if they are being delivered.

Don Gutmann: We have not removed any of these businesses from the calculation to this point. We have been waiting for a recommendation from the committee. So you might still see a large auto dealer with a large gain or loss in your jurisdiction.

Valerie Torres: We don't know how many of these businesses there are. The potential here is that every jurisdiction is affected in some way. Our current solution is to leave these in the calculation unless they were removed for some other reason. That was after calling the taxpayers.

With auto dealers we have the unique case where they are also reporting the extra 0.3 percent multimodal tax for auto sales and leases. We can compare their retail sales to what they report on line 25 of the excise tax return. We looked at that and if they report 70 percent of their sales on line 25, they are more likely to not do deliveries of parts. Our suggested option is to remove all businesses reporting more than 70 percent of their taxable retail sales on line 25 of the combined excise tax return.

Glen Lee: How did you pick 70 percent?

Valerie Torres: We looked at the mitigated NAICS codes and compared the percentage of motor vehicle sales to the total taxable retail sales for the businesses. For the group that reported more than 70 percent of their sales on line 25, most of those said they were auto dealers.

Lorrie Brown: Would it be reasonable to assume that the car sales and parts sales are proportional across jurisdictions?

Valerie Torres: I don't think so. You are more likely to have jurisdictions that have a lot of car dealers versus a lot of parts dealers. We would have to look at each business and proportion out their car sales and parts sales.

Lorrie Brown: If one jurisdiction sells a whole bunch of cars and everyone else sells parts, you would overestimate that jurisdiction.

Don Gutmann: The other 30 percent isn't just the sale of parts. It is also repairs.

Bob Nachlinger: The breakdown might be 70 percent cars, 20 percent repairs, and 5 percent parts.

Lorrie Brown: That's the part I was missing.

Neil Kruse: The parts dealers are more likely to have deliveries to other jurisdictions.

Shelley Coleman: I wouldn't like to see us do an across-the-board removal. I haven't seen a change in the data for our jurisdiction.

Don Gutmann: Is everybody okay with our recommendation for auto dealers? The committee recommendation is Option A.

Option A is: Remove all businesses reporting more than 70 percent of their taxable retail sales on line 25 (code 120) of the combined excise tax return. This would eliminate auto dealers which do mostly motor vehicle sales. However, this could eliminate some which report both auto sales and parts sales.

Valerie Torres: The next group is the boat dealers. Option A is to remove all businesses in the Boat Dealer NAICS. With a boat dealer you have the same issue where if they sell a boat, they also sell parts. This option would eliminate them from the calculation.

Option B is for the Department of Revenue to review the top X businesses in the Boat Dealer NAICS and also to review any that are brought forward by the jurisdictions. We actually have started reviewing those businesses because some looked odd anyway. There were 212 businesses in the Boat Dealer NAICS. We reviewed the top 50 and found 13 that needed to be removed from the calculation and 12 that needed to be left in. We are contacting the other 25 to see if they reported to more than one location because of their Internet sales or their parts sales or both.

Option C is to leave all boat dealers in the calculation.

Jim Harden: The only difference with boat parts is a lot of boaters who go to the San Juans need to have the parts flown in. They are installed by a local mechanic.

Rick Peterson: These 12 that needed to be included – what is the story on them?

Valerie Torres: Several were in the boat dealer NAICS but they don't sell boats. They are more a parts dealer. We could see that they made the change. We contacted them and they said they don't sell boats. I would personally recommend that you do Option B.

Dean Carlson: I would think Option B too, because you can't tell easily with boat dealers like you can do with cars.

Jim Harden: In recommendation B, what is the value of X?

Don Gutmann: We would look at at least the top 50.

Valerie Torres: The top 50 represent boat dealers reporting more than \$1 million in taxable retail sales for three quarters in a year.

Don Gutmann: So we will go with Option B and we will at least do the top 50, but we will do as many as we can.

Option B is: The Department of Revenue would review the top X businesses in terms of taxable retail sales in the Boat Dealer NAICS which reported to more than one location in the destination period. The Department would also review any which are brought forward by local jurisdictions for review.

Bob Nachlinger: Can I amend that to say – since we already did the top 25 – can we put at least 75?

Valerie Torres: For manufactured homes, our options are to remove all the businesses, or to review all of the businesses and remove those not affected by the change, or to leave all of them in the calculation. There are 59 in this list. We will do Option B.

Option B is: Due to the limited size of this group of businesses, the Department of Revenue would review all of these businesses and remove those not affected by the change to destination-based sales tax.

Out-of-state Businesses (continued)

Valerie Torres: Going back to Bob's question of the dollar value of total retail sales for the out-of-state businesses, the 4,000 suspected out-of-state businesses had \$953 million in taxable retail sales. The top 117 of these businesses had \$471 million. The issue is that these businesses were destination before and are destination after. We are checking to be sure they are truly out-of-state businesses.

Don Gutmann: Is everyone okay with Option 1?

Option 1 is: The Department of Revenue would review the top 117 of these businesses in terms of taxable retail sales from the list of suspected out-of-state businesses. These 117 represent approximately 50 percent of the total taxable retail sales reported by the suspected out-of-state businesses. In addition, the Department of Revenue would review any suspected out-of-state businesses brought forward by local jurisdictions for review.

PAST PAYMENT ADJUSTMENTS

Don Gutmann: At this point we have briefed the Director and Deputy Director of our agency and OFM on this issue of past payment adjustments. We will probably have a recommendation from OFM in a couple of weeks, but we will be able to have an answer for you at the next meeting.

Look at the handout in your packet that shows the impact of past payment adjustments by jurisdiction for three quarters. You will see that for the first three payments Kent has received \$3,260,348 without the voluntary seller's adjustment. They should have gotten \$3,406,334.

We made the plus and minus adjustments. If we made an adjustment, there would be no impact for the first quarter. For the second quarter if we removed a firm, we went back and adjusted for that firm. If we removed a firm in the third quarter, we went back and adjusted for the first two quarters. All the ones with no payments were positively impacted and are still positively impacted by the change to destination-based sales tax. A number of jurisdictions received a payment in the first quarter but when we made adjustments, they didn't get a payment after that.

Valerie Torres: These numbers include the adjustments made in the first three quarters.

Karen Jester: We sent information in for prior quarters and haven't heard back from Matt yet. So this could be wrong for us.

Shelley Coleman: Could these impacts be from issues other jurisdictions brought up?

Don Gutmann: Yes. This is the computer equipment companies.

Rick Peterson: The handout listing mitigation adjustments – is that the list of adjustments made in this?

Don Gutmann: Most of them have been made.

Valerie Torres: The list of mitigation adjustments is for adjustments made to the December, March, and June payments.

Don Gutmann: The two pages showing the impact of adjustments by industry and by jurisdiction were done as a result of a request from Glen Lee.

Valerie Torres: When we do the annualization, we will run this list again.

Jim Justin: So the big picture of what was budgeted for mitigation and what was actually distributed – you're way under the amount that was budgeted?

Don Gutmann: Yes.

Jim Justin: Are you still conferring with the AG?

Don Gutmann: No – they have already given us their opinion.

Lorrie Brown: We asked our legal staff and they concurred with the AG.

Jim Justin: What was the question?

Don Gutmann: If we make adjustments, can we only make adjustments for the underpayments? The AG said if we are doing it, we have to do it both ways.

Jim Justin: Can I ask the committee members what their opinions are?

Bob Nachlinger: I continue to feel the money allocated in the mitigation budget is way in excess of the money paid, and I think you should pay all the jurisdictions out of that money. If it is going to have to shift between the winners and losers on this list I'm not happy about it, but I still want my \$150,000.

Rick Peterson: This is when the cities and counties get together and find a way to share the money without making adjustments.

Shelley Coleman: This is three-fourths of mitigation. For our city we have been overmitigated. Until we hear back on the questions that we asked about the differences, this isn't really transparent to me. I am going to have a tough time with my elected officials – telling them I don't know why; this is what DOR told us. To say that we are overmitigated before we have any answers to our questions, it is difficult for me. There is no transparency to see what the cause of this was.

Don Gutmann: This is only three quarters – we do not have the final word yet. If we had to go back and make these plusses and minuses, we would wait until we annualize the payments.

We prepared the mitigation adjustments paper to show you how we have been spending our summer. We have been in the true-up period for the last three months. We have looked at a lot of various issues and firms. We have been making adjustments to the data. The back of the list shows the adjustments that we plan to make in the next couple of months or before we annualize including the ones we talked about today – auto dealers, out-of-state businesses, boat dealers. We have done a lot to look at the data and find the changes that are due to destination sourcing. The annualization schedule shows two possible options. This is the last quarter where we will compare Fiscal Year 2009 to Fiscal Year 2008 – before and after. So for the December payment, what do we do? Do we compare Fiscal Year 2010 to Fiscal Year 2008 or do we annualize?

Kim Davis: The reason why we are talking about this is because the legislation is very specific that once we annualize, we can only make adjustments once a year.

Don Gutmann: On the sheet showing the options, Option 1, the four quarters in green are what we are in now. One thing that we are proposing which is Research's preference is that we annualize the December payment. You will know the amount of your payment except for the voluntary sellers' amount. The other side of this sheet shows the proposed annualization schedule. We will send the data to you October 6 and you have four weeks to get your data back to us.

Lorrie Brown: Can't we do the true-up and call it the once-a-year meeting?

Kim Davis: We don't have the annual tax returns that make up 0.7 percent of the total. They won't be available until next spring.

Lorrie Brown: And they can be rolled into the annual meeting?

Kim Davis: Yes.

Lorrie Brown: You could have that meeting after the annuals are in in the spring instead of waiting until early fall. If there is a big change for a jurisdiction, they don't have to eat it for that long.

Jim Justin: The December payment goes out and the next three payments are the same?

Don Gutmann: Yes.

Bob Nachlinger: My only concern on this – from my standpoint we would have two more quarters to square up the data. Do you feel it is pretty much squared up now?

Don Gutmann: Yes.

Bob Nachlinger: When I get the fourth quarter data, this will be new stuff for me. It will take me some time to go through it.

Don Gutmann: There is a small window for us to get the data from the jurisdictions and for us to review it.

Lorrie Brown: If we go for another year are we locked into the methodology we are using or could we do another methodology? Could you take last year's mitigation amounts and put a seasonal factor on them?

Kim Davis: The law says we have to do a quarterly evaluation.

Jim Harden: Could you take Quarter 4, 2008 and compare it to Quarter 4, 2009?

Valerie Torres: No, because annuals wouldn't have reported any change to mitigation until they submit their annual tax return in January 2010.

Kim Davis: When we first started having these meetings and coming up with issues, it seemed like there were a lot of issues to address. We actually started the true-up as soon as the first payment went out. So we feel really confident that we have scrubbed the data a lot quicker. We have thrown a lot of resources at this.

Don Gutmann: If a jurisdiction wants us to review all of their firms, we wouldn't do it. We would prioritize the data and look at the largest businesses in the jurisdiction. We have only a small window to allow jurisdictions to get information back to us.

For Option 2 we continue the quarter to quarter analysis but we will be doing 2010 against 2008 and we don't annualize until the summer. That would give the jurisdictions a lot more time to review their data. But I would be very hesitant to compare 2010 to 2008.

Jim Justin: Do we really have a choice?

I am with you, Bob -- I would like to include two more months.

Bob Nachlinger: The law does allow that. It is not precluded from us going six quarters.

Valerie Torres: That means you would have to do a Fiscal Year 2010 comparison to Fiscal Year 2008.

Bob Nachlinger: If something comes up in the fourth mitigation payment and I don't get the stuff back to you before November 5, if it is a hit to me, I have to take that hit for a year before it can be changed. With new data coming to me, I will try to get it to you on time.

Shelley Coleman: Is there any way that we can have some more time? I would like a wider window to review that file data.

Bob Nachlinger: I am spending 80 percent of my time now on budget and not on sales tax.

Valerie Torres: The issue is once you give us the information we have to contact the businesses, and that takes at least three and a half weeks to do.

Lorrie Brown: Can you make a preliminary mitigation payment and then another one in a few more weeks? On December 31 send out 75 percent of the payment, and send them the rest a month later.

Valerie Torres: It has to go out the end of the quarter.

Don Gutmann: When we calculate the annual, that is the preliminary annual.

Lorrie Brown: I am saying no, this isn't it. We are going to do this in two stages and send a partial payment. Then send them the rest of their money a month later.

Don Gutmann: What about if we do the quarterly calculation for one more quarter? Shelley, you said the time we give you isn't enough?

Shelley Coleman: When we go through the detailed data for the fourth quarter we compare it to the third, second, and first quarters, so it takes a lot of time.

Karen Jester: You guys want a lot more detail, which we try to provide you, and it isn't enough time.

Rick Peterson: This is based on when the fourth quarter data is available.

Valerie Torres: I have the fourth quarter data.

Bob Nachlinger: Could you send us a file on September 19?

Valerie Torres: No – it takes from September 19 to October 5 to get you a file. It requires a weekend to get the data out of the master data base. It is a 23-hour process to get the data, so it has to be done over the weekend. We have all the adjustments ready to go and we start running it. Then there is a review process that we go through before we send it to you.

Don Gutmann: Would two weeks make a difference to the jurisdictions? You have almost four weeks now.

Valerie Torres: Getting the data to you on September 18th gives you three more weeks.

Don Gutmann: Will that work for you, Bob and Shelley?

Bob Nachlinger: If you run the data on the 19th and 20th and get something to me on the 21st, I would have six weeks.

Valerie Torres: My point is you can't run it on the 19th and get it to you on the 21st. I have to have two weeks.

Don Gutmann: We will try to give you at least an extra two weeks.

Glen Lee: Could you do a preliminary payment in December and then on February 1 we say the final is this? Does the legislation dictate the process for calculating the payments?

Kim Davis: We would have to talk to our legal counsel and find out if that would be an option.

Shelley Coleman: If we take this one more quarter and set the March payment as our first annualization, what precludes us from doing that?

Don Gutmann: But we would be comparing Fiscal Year 2010 to Fiscal Year 2008 for that first quarter.

Lorrie Brown: What if the first quarter is based on one-fourth of the year plus some adjustments from the previous quarter?

Kim Davis: We asked about this and we were told no.

Once we get past July we are looking at Fiscal Year 2010 and you would be comparing Fiscal Year 2010 to Fiscal Year 2008.

Valerie Torres: You would have a two-year gap in the calculation.

Kim Davis: Right now we are doing April, May, and June 2008 to April, May, and June 2009. So you are comparing origin to destination.

Don Gutmann: Are you okay with Option 1 with the extra two weeks? The other option is to go for one additional quarter and then we annualize.

Glen Lee: Is there a solution to give us another month of analysis time? We are completely swamped on budget at this time. I can deal with it because we are a large city and have more staff.

Kim Davis: I understand we want to go with Option 1; however, we want the December payment to be a partial payment to give the jurisdictions more time to look at the data and to give us more time to review and then true up the December payment at a later date.

Glen Lee: I think the real goal is analysis time. I would rather that be the objective as opposed to specifying a partial payment. I am not comfortable with that.

Lorrie Brown: Can we have some of us numbers people meet with Greg to look at other estimation techniques? There are other estimation techniques that we could come up with and come up with another solution. It seems like this is kind of a big deal. Julie Murray and I wrote

this legislation and we did not intend it to be so hard and fast. We wanted to give the committee some flexibility. There should be some other reasonable approach that we could use.

Rick Peterson: The question is your workload level – is two weeks in September better than two or three weeks in November?

Bob Nachlinger: Four weeks is going to be really tough at this time of year. Six weeks would be better. If you give me an extra month, I would be good.

Dean Carlson: Is this number needed for your budget process?

Bob Nachlinger: Yes.

Rick Peterson: In this scenario it is about two months until the check goes out. So you need through November and the makeup payment would be at the earliest at the end of January and maybe into February.

Valerie Torres: It would be the end of February. There is no way it could happen in January. It takes us four to six weeks to get information back from the taxpayers.

Shelley Coleman: We need the extra couple of weeks at a minimum. If you can look for a way to give us more time, that would be helpful.

Kim Davis: Would it work, rather than waiting until October 30, that as you find things you turn them in periodically?

Valerie Torres: The majority of the jurisdictions have gotten back to us at least a week early, and we work them as soon as they come in.

Don Gutmann: We don't want to do the quarter to quarter calculation. Research and TAA will come up with a new proposed schedule and come up with as much time as possible. We will get together with Lorrie and Glen and Greg to see if we can come up with some other technique for the calculation.

Lorrie Brown: The other question is what constitutes doing the estimate quarterly? In my mind taking the amount and putting a seasonal adjustment on it would constitute a quarterly estimate.

Shelley Coleman: That's kind of fuzzy.

Don Gutmann: The goal is to give the jurisdictions as much time as we can to look over the data.

Rick Peterson: How are you going to make a decision on this? Are you going to e-mail folks?

Don Gutmann: I want to get together internally first and then together with Greg and the others within the next week.

Bob Nachlinger: Can you do the new schedule and send it to the listserv?

Valerie Torres: Am I hearing that seven and a half weeks is enough time?

Don Gutmann: We will focus on the schedule and get it out in the next week.

The next meeting is scheduled for October 1.

Minutes submitted by Diane Mielke