

Streamlined Sales Tax Governing Board Meeting

December 19, 2011

Conducted by teleconference

Welcome and Roll Call of Member States:

President Luke Kenley called the meeting to order at 10:00 am. All member states were present.

Approval of minutes from October 5-6, 2011 meeting:

The minutes were approved on a voice vote.

Final Action on Amendments from Previous Meeting:

Ms. Sherry Hathaway said that AM11002A01 was first approved at the October meeting and required a second vote for final approval. She reminded the Governing Board that this amendment addressed the issue of what taxes impose on a retailer can be excluded from the definition of “sales price.” Ms. Hathaway moved adoption of AM11002A01. That motion was approved on a unanimous vote.

Reports of committees:

- Executive Committee

- **Marketplace Fairness Act Bill (MFA)**

President Kenley reported on his participation in a hearing in front of the US. House Judiciary Committee regarding state authority over remote sales tax collection. He said that his opinion from the committee’s questions and comments that it was no longer a question as to whether we can get this done, but a matter of when. Mr. Scott Peterson said it was the best hearing from our perspective that he has ever seen on this topic. President Kenley said that much of the discussion was around how to make this work for small sellers and the necessity to make it work.

- Compliance Review and Interpretations Committee

- **Annual State Recertification Report**

Mr. Peterson thanked the states, Ms. Pam Cook, Chairman Myles Vosberg and the other members of the Compliance Review and Interpretations Committee (CRIC), and Mr. Fred Nicely and all the members of the Business Advisory Council (BAC) for their hard work completing the 2011 state recertification process. He said the recertification process is the Governing Board’s annual confirmation of the promise states made to be consistent in the way each reads their identical statutes.

Mr. Russ Brubaker said there were two compliance positions he thought required careful attention and discussion. He said that the Governing Board should look carefully at the West Virginia motor vehicle recommendation and the finding of Tennessee's noncompliance.

Mr. Nicely said that during the review the BAC had wanted CRIC to find Indiana, Utah and Vermont out-of-compliance for the way they treat remotely accessed prewritten computer software. Mr. Vosberg said CRIC did not raise this as a compliance issue because of the need for a consensus position. Mr. Nicely said these four states tax the access of prewritten computer because it is tangible personal property. He said there are definitions of ways two deliver prewritten computer software such as load and leave, but there isn't for accessing the software. Mr. Brubaker said there seems to be some ambiguity regarding how this should be treated. He said this may require clarification of the Agreement and felt it should be reviewed by SLAC and they should report back on their findings. Mr. Nicely said he didn't think there was any ambiguity. He said the BAC thought this issue was decided when all of the digital dispositions were adopted. Mr. Mark Nebergall said that from his participation on the digital goods working group access to software was a digital good. Mr. Bruce Johnson said he too participated on the digital goods working group and prewritten software was to be completely excluded from digital goods. Mr. Brubaker moved that the issue be assigned to SLAC. That motion was approved on a voice vote.

Mr. Vosberg said CRIC found no issues with the 13 following states: of Arkansas, Georgia, Iowa, Kansas, Kentucky, Nebraska, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Washington and Wisconsin.

Mr. Vosberg reported that CRIC recommended that **Indiana** be found out-of-compliance with the following issues:

- The exemption for free samples of prescription drugs includes prescription drugs, drugs containing insulin or an insulin analog, and blood glucose monitoring devices. Durable medical equipment is exempt only with a prescription. The blood glucose monitoring exemption does not require a prescription.
- The statute cited for the rounding rule (Section 324) does not address allowing sellers to elect to compute tax on an item or invoice basis.
- The state will not be able to accept the SER from Model 4 sellers until February, 2012.

Mr. Larry Molnar agreed with CRIC's analysis and said they have draft legislative solutions for each. Senator Deb Peters moved that Indiana be found out-of-compliance. That motion was approved unanimously on a roll call vote with Indiana abstaining.

Mr. Vosberg reported that CRIC recommended that **Michigan** be found out-of-compliance because their statute taxing telecommunications service excludes one-

way paging service. He said that paging service as defined in the Agreement includes both one-way and two-way service. He said the Governing Board decided in August 2010 meeting that they would have to be all taxable or all exempt.

Mr. Mike Eschelbach said his legislature has not yet taken up the issue, but hopefully it will be done this year. Mr. Nicely of BAC said they agree that Michigan should be found out-of-compliance. Senator Peters moved to find Michigan out-of-compliance. That motion was approved on a roll call vote with nineteen states voting yes, Minnesota voting no, and Michigan abstaining.

In response to a question from Representative Pat Childers concerning sanctions, Mr. Peterson said the Governing Board's bylaws and rules provide the process for determining and imposing sanctions. He said before a state could be sanctioned they must be found out-of-compliance and either disagree or ignore the decision. He said with the appeal process it takes approximately 6-months before a sanction can be imposed.

Mr. Vosberg reported that CRIC recommended that **Minnesota** be found out-of-compliance because their definition of "prepared food" does not include "two or more food ingredients mixed or combined by the seller for sale as a single item." He said that the definition also includes food sold without eating utensils in an unheated state by weight or volume as a single item, but exempts ready-to-eat meat and seafood in an unheated state sold by weight. Chairman Vosberg said that since CRIC voted on Minnesota the first issue was resolved and the only issue was meat and the seafood.

Mr. Jack Mansun said the meat and seafood distinction was in Minnesota law when they were admitted to the Governing Board and doesn't understand why this is now an issue. He said their local business community lobbied for the meat and seafood exception and it was listed on Minnesota's Taxability Matrix. Mr. Mansun said Minnesota believes they are substantially in compliance. Senator Dwight Cook said he agreed with Mr. Mansun's comments and that the Governing Board needed to take a look at all the uniformity requirements to determine which add value. He recommended that Minnesota be found in-compliance.

Mr. Nicely said the BAC sees this as a compliance issue because they had heard from three grocery store chains. He recommended that the Governing Board enforce uniformity. Mr. Nebergall said one exception will lead to others and soon there will be problems with other states. Delegate John Doyle said he disagrees with Mr. Nebergall and Mr. Nicely. He said that if the Governing Board continues to hold an absolute line after federal legislation passes in its current form no state would remain within Streamline and all the important simplifications and uniformity would be lost. Mr. Bruce Johnson agreed with Delegate Doyle that there are things in the Agreement that are unduly restrictive. He said the proper thing to do is to clarify the Agreement where it needs to be clarified. Senator Kenley said he does not support this as a compliance issue. Senator Peters said that Minnesota should be found out-of-compliance on this issue. Mr. Nicely reminded the Governing Board that three

grocery chains felt the uniformity issue was very important. Mr. Vosberg said none of those grocers testified during the CRIC hearing. Mr. Mansun said Minnesota was confused by Mr. Nicely's statement since the Minnesota Grocers Association lobbied for this issue. Mr. Jerry Johnson said he appreciated Senator Cook's comments on the need to review these types of issues, but he does not feel that it is with a compliance vote. Delegate Doyle said he was comfortable with all that and wanted to caution everyone about what the future may be like. Ms. Susan Mesner said they are a small state with little dedicated staff to Streamlined and these small issues is getting very hard for some states to keep up with. Mr. Brubaker said the Governing Board may need to evaluate what is important in terms of compliance and get focused on what's important. Mr. Craig Johnson said CRIC voted to find them out-of-compliance because they did not comply with the uniform definition. Senator Peters moved that Minnesota be found out-of-compliance. That motion was approved on a roll call vote with nineteen states voting yes, North Dakota voting no and Minnesota abstaining.

Mr. Vosberg reported that CRIC recommended that **Nevada** be found out-of-compliance for not having the 120 day local rate change notice for catalog sales and because they don't relieve in-state sellers of direct mail of the obligation to collect tax when their purchasers provide the direct mail form or exemption certificate claiming direct mail. Mr. Chris Nielson said no local government in Nevada can raise their rates without Legislative approval, but he would take the two issues to his Legislature.

Mr. Bruce Johnson said he disagreed that Nevada was out-of-compliance on the 120 day requirement. He said SSUTA Section 305 B ties the requirement to provide 120 days notice to changes in local rates and in Nevada's case their local governments cannot raise their rates unless the Legislature grants them the authority. He said that without that grant of authority no local government in Nevada can raise a rate and if they cannot raise their rate they cannot violate the 120 notice requirement. Mr. Nebergall said the BAC understood, but was concerned that without this in their law the Governing Board would be put in the position of sanctioning a state for having done something that was already in the past and for which the state no longer violated.

Mr. Bruce Johnson moved that Nevada be found out-of-compliance with only the direct mail issue. That motion was approved on a roll call vote with seventeen states voting yes, with Indiana, Minnesota and South Dakota voting no, and Nevada abstaining.

Mr. Vosberg reported that CRIC recommended that **New Jersey** be found out-of-compliance because they are unable to accept the SER from anyone except Model 1 sellers. Ms. Denise Lambert-Harding said they were very close, but did not yet have it finished. Senator Peters moved that New Jersey be found out-of-compliance. That motion was approved on a roll call vote with nineteen states voting yes, Nevada absent and New Jersey abstaining.

Mr. Vosberg reported that CRIC recommended that **Ohio** be found out-of-compliance because their statute providing notice for the effective dates for catalog sales and boundary changes limits the notice requirement only to sellers registered under the centralized registration system and not all sellers as it should. Ms. Phyllis Shambaugh said that Ohio does give notice to all sellers by administrative practice, but their statute has the wrong wording. Mr. Nicely said Ohio may comply by practice, but their law makes them out-of-compliance. Mr. Richard Dobson said if their statute specifically said the opposite, then he would agree they are not in compliance, but when it talks about sellers, they will give notice to any seller that is registered. Senator Peters moved that Ohio be found out-of-compliance. The motion failed on a roll call vote with South Dakota voting yes, Ohio abstaining, and nineteen states voting no.

Mr. Vosberg reported that CRIC recommended that **Tennessee** be found out-of-compliance with Governing Board rule 801.1 which sets the criteria for associate state membership. Ms. Sherry Hathaway said the issues Tennessee hasn't yet completed are the same as the day Tennessee was admitted as an associate member. She said it was the drop shipment provision that Tennessee has not changed that is a violation of this rule. Ms. Hathaway said that Tennessee was grandfathered as an association member and as such this rule does not apply. She said they believe the Governing Board has already made this decision that rule 801.1 did not apply to the grandfathered states. Senator Peters made a motion that Tennessee be found out-of-compliance. Mr. Brubaker said he doesn't understand why this is an issue because as he reads the Agreement a state that was an associate member on 1/1/07 remains one until voted out by the Governing Board. He said the Governing Board voted on this when it adopted Rule 801.3 and he planned to vote no on the motion. Mr. Nicely said the associate state change made in 2009 corrected a quirk in the Agreement where the states were not reviewed on an annual basis. He said that it is clear that the grandfathered states are in until the Governing Board finds them out-of-compliance. He said the state must comply with the drop shipment rule and it is finally catching up with Tennessee that they have not adopted the drop shipment rule and they should be found out-of-compliance.

Mr. Peterson said the affect of the motion as it was worded by CRIC would be that Tennessee would be excluded from the Agreement. He said the effect of the motion would be to kick Tennessee off the Governing Board. Mr. Nicely said that in 801.3-B the Governing Board does not have to find they are no longer an associate member, but simply that they have a compliance problem. Mr. Peterson said the compliance list Tennessee has provided to the Governing Board every year since their associate membership has said they have not complied with the drop shipment rule.

In response to a question from Delegate Doyle, Mr. Peterson said it would not be possible to find Tennessee out-of-compliance under some other rule which would not kick them out. He said the BAC did not like what happened in 2009 because it was the intent of that motion that Tennessee be grandfathered as an associate member. He

said they are different that Utah and Ohio because they are full member states in waiting, but there is no such category. Delegate Doyle said he felt it would be ridiculous to kick a state out for this. Mr. Nicely said they are not looking for the Governing Board to kicked Tennessee out, just that that Tennessee be voted out-of-compliance on section 805.

Mr. Bruce Johnson moved that the Governing Board defer action on this and refer it to the Executive Committee. He suggested that Scott Peterson, Fred Nicely, Sherry Hathaway and himself should participate. Ms. Hathaway said she has no concerns with sending this to the Executive Committee, but believed they have had this discussion and it is not fair to say that the rule does not apply to the grandfather states. Mr. Nicely said he felt the Executive Committee review would be helpful. The motion was approved on a roll call vote with twenty-two states voting yes, Tennessee abstaining, and Iowa absent.

Mr. Vosberg reported that CRIC recommended that **Utah** be found out-of-compliance because their law setting the effective date for rate changes on services covering a period of time only address repeals of a tax and are based on bill periods instead of the dates bills are rendered. Mr. Bruce Johnson agreed their statute is incorrect. Senator Peters moved that Utah be found out-of-compliance. That motion was approved on a roll call vote with twenty states voting yes and Utah abstaining.

Mr. Vosberg reported that CRIC recommended that **Vermont** be found out-of-compliance because their statute imposing tax on “specified digital products transferred electronically” doesn’t match the state’s position that it taxes these products regardless of whether or not they are sold with the rights of use less than permanent or conditioned on continued payment.

Ms. Susan Mesner said Vermont would amend their statute. Senator Peters moved that Vermont be found out-of-compliance. That motion was approved on a roll call vote with nineteen states voting yes, Minnesota absent, and Vermont abstaining.

Mr. Vosberg reported that CRIC recommended that **West Virginia** be found out-of-compliance because they require motor vehicle lease payments to be made to the West Virginia Division of Motor Vehicles which does not conform to the single entity requirement in Section 301 of the SSUTA and it does not comply with the uniform return and remittance provisions in Sections 318 and 319 of the SSUTA.

Mr. Craig Griffith said that West Virginia changed the tax on leases to facilitate the state’s ability to create an exemption. He said the DMV form leasing companies use to file is easier than the state’s sales tax return and there is no way for the state to track the collections using the simplified electronic return. Senator Peters moved that West Virginia be found out-of-compliance. Mr. Brubaker reminded the Governing Board that auto sales and leases are generally excluded from the SSUTA because states have historically treated motor vehicles differently than other products. He said if the DMV process is simpler for taxpayers the Governing Board should perhaps

consider this to be substantial compliance. Ms. Val Pfeiffer said it's fair for West Virginia to say the business community has been doing this for a long time. She said a company new to West Virginia complained about the DMV registration requirements including having their officers fingerprinted, providing a picture of their office building and several other things just to be allowed to collect their sales tax. Ms. Pfeiffer said some of the registration requirements in West Virginia are much different than in any other state. Mr. Griffith said his office wasn't aware of all the DMV requirements and said he could not explain their reasons for them.

Delegate Doyle suggested that their DMV's actions may have something to do with Real ID, and if so, might be coming to other states very soon. Mr. Griffith said it might not be good for leasing companies go thru that process may not be a good idea. Mr. Nicely said explained the burden imposed on some leasing companies that have to file with both the DMV and the DOR in West Virginia. Ms. Pfeiffer said the BAC recognizes that this has been in effect in West Virginia for some time and that both parties need to come to the table to try to figure out how to best work this out. Senator Dwight Cook moved that Senator Peters' motion be tabled. Mr. Peterson reminded the Board that approval of the motion would mean that the Governing Board was finding West Virginia in compliance. Senator Cook's motion was approved on a unanimous vote with 23 states voting yes and West Virginia abstaining.

Mr. Vosberg reported that CRIC recommended that Wyoming be found out-of-compliance because their statute exempts "one-way paging unit" and the Governing Board has determined that paging is both one-way and two-way. Mr. Dan Noble said they are promulgating rules to address the issue. Senator Peters moved that Wyoming be found out-of-compliance. That motion was approved on a roll call vote with twenty states voting yes and Wyoming abstaining.

- **Interpretation requests**

- **Wood chunks as a food or food ingredient**

Mr. Vosberg reported that Mr. Ken Nogueira had submitted an interpretation request to determine whether wood chunks used for flavoring in cooking qualifies as "food and food ingredients." Mr. Vosberg reminded the Governing Board that the definition of "food and food ingredients" is "substances, whether in liquid, concentrated, solid, frozen, dried or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value."

Mr. Vosberg said CRIC decided that wood chunks, even those containing natural compounds or additives that emit a particular aroma or vapor, are not sold for ingestion or chewing by humans. He said notwithstanding that the smoke flavors the food the wood chunks are not eaten by humans and do not become a component part of and are not added to the food product.

Mr. Vosberg said that based upon the forgoing, CRIC decided wood chunks do not qualify as a “food and food ingredient” because it is not sold for ingestion or chewing by humans.

Mr. Nogueira said that he thinks the confusion is that the wood is a separate and distinct item from the smoke. He said his argument is that the smoke is in a different form and is a flavoring. He said the only reason anyone purchases the product is to add flavor and they are consumed by the cooking process. He said that in West Virginia and Arkansas food ingredients list includes extract seasoning, herbs, etc. as a cooking ingredient and all they do is add flavor. He said it is the flavor of the wood that becomes part of the end product. He said it was the molecules of the wood that are the wood smoke flavor which is the finished product and that’s the only reason for doing them. He said SST doesn’t have a definition of food and a different definition of food ingredients. He said it would seem those molecules that are a part of the final product become a part of the food product whether you do it by smoking it or rubbing it, it doesn’t seem to make a difference.

Mr. Kevin Fisk of the Grocery Manufacturing Association said the Food and Drug Administration considered wood chips to be a food ingredient under approved conditions and referred the Governing Board to one of their regulations.

Mr. Craig Johnson said CRIC did not discuss the federal rule. Delegate Doyle said he understands the point of the opposition that the aroma gets up into the food just like gas, but he does not agree the wood is an ingredient. Mr. Richard Cram said CRIC distinguished the aroma from something you chew or ingest and agreed that the wood is not used as a fuel.

Representative Childers said if there’s smoke involved, then the wood chunks are being burned which means they are fuel. Mr. Fisk said the smoke is derived as the result of the burning process to allow the vaporous gas to coat the food, thus becoming a food ingredient. Mr. Eschelbach moved he adoption of the CRIC ruling. That motion was approved on a roll call vote with twenty states voting yes and Vermont absent.

- **Pencil lead/pen refills for sales tax holiday**

Mr. Vosberg said that North Carolina had submitted a request to determine whether pencil leads and pen refills qualify as school supplies for sales tax holiday purposes. Mr. Eric Wayne said that pencils and pens are on the list in Appendix B as school supplies but pencil leads and pen refills are not on the list.

Mr. Vosberg said CRIC is recommending that pen refills and pencil leads are components of pens and pencils and fall within the meaning of pens and pencils as defined in Appendix C, Library of Definitions, Part III Sales Tax Holiday

Definitions. Mr. Vosberg said while the Agreement does not define pens and pencils, they cannot perform in their intended purpose without pen refills and pencil leads.

Mr. Craig Johnson said he voted against the interpretation because the definition of school supplies is an all inclusive list. Mr. Mark Haskins said Virginia adopted the SST definition and would concur that the pencil leads and pen refills are pens and pencils. Senator Peters moved adoption of the interpretation. That motion was approved on a roll call vote with seventeen states voting yes, North Dakota voting no, and Nevada and Vermont absent.

- **120 day rule for providing exemption certificates**

Mr. Vosberg said the SST Audit Committee submitted an interpretation request asking whether a state could include its statutory appeal period in the 120-day period required by Section 317 D (1) of the SSUTA. Mr. Vosberg said that CRIC is recommending that if a state will adjust the audit assessment during the appeal period if acceptable documentation is provided, the appeal period can be included as part of the 120 days allowed to provide exemption certificate information. He said that however, if a state will not adjust the audit assessment during the appeal period for exemption certificates accepted in good faith, the state may not include the appeal period as part of the 120 days that must be allowed.

Mr. Nicely said the BAC's concern is that states are being asked to work with taxpayers and currently none of the states require payment of the tax and the business community hopes that doesn't change. Mr. Eschelbach moved the adoption of the interpretation. That motion was approved on a roll call vote with nineteen states voting yes, and Nevada and Vermont absent.

New Business:

Delegate Doyle said he and other legislators heard comments from legislators about states giving up their sovereignty by joining the Governing Board. He suggested the Executive Committee consider ways of eliminating those concerns, including changing the Governing Board's name and what keeps those states from joining. Mr. Brubaker said he would have the Executive Committee take this up in 2012.

There being no further business Senator Kenley adjourned the meeting 1:14 PM central.