

Interpretive Rule related to proposed amendment AM08014A01

Rule _____ - Prohibition of Replacement Taxes

1. This rule provides guidance in applying the prohibition against replacement taxes in Section _____ of the Agreement. A “prohibited replacement tax” is a tax imposed outside a state’s general sales and use tax, on or with respect to a product or products that are defined in Part II or Part III(B) of the Library of Definitions (except alcoholic beverages or tobacco), that has the effect of avoiding the intent of the Agreement. A Governing Board determination whether a particular replacement tax is a “prohibited replacement tax” shall be based upon an examination of all the facts and circumstances according to the procedure established herein.

2. To determine that a tax is a replacement tax, the Governing Board must find by affirmative vote of three-fourths of the full member states, excluding the member state that is the subject of the question which shall not vote on the question, the following:

a. at the time of the adoption of the tax, the tax was specifically imposed on or with respect to a product that was defined in Part II or Part III(B) of the Library of Definitions, or on products subsumed within such definitions, except alcoholic beverages and tobacco, and;

b. either:

i. in proximity to the time the state initiated action to become a member state, a tax was imposed upon such product by statutes which are subject to the requirements of the Agreement as identified in the state’s Petition for Membership filed with the Governing Board, or;

ii. after the state became a member state, a tax was imposed upon such product by statutes which are subject to the requirements of the Agreement as identified in the state’s Petition for Membership filed with the Governing Board, and;

c. the tax imposes an additional administrative burden on sellers of the product which would not be imposed if such tax were subject to all of the requirements of the Agreement with regard to sales and use taxes.

3. To determine that a replacement tax, as provided in subsection 2, is a prohibited replacement tax, as provided in Section _____ of the Agreement, the Governing Board must find that the replacement tax has the effect of avoiding the intent of the Agreement, considering the following factors:

a. whether the tax contains both a sales and a use tax component;

- b. any other factors related to the fundamental purpose expressed in Section 102 of the Agreement that the Board considers relevant.

Such finding shall be by affirmative vote of three-fourths of the full member states, excluding the member state that is the subject of the question which shall not vote on the question.

4. Taxes that are not prohibited replacement taxes include, but are not limited to:
 - a. taxes on alcoholic beverages or tobacco;
 - b. in general, taxes based on measures other than price, such as weight or volume;
 - c. lodging or hotel occupancy taxes, and;
 - d. in general, broad-based business activity taxes

5. Examples:

Example 1 – Prior to joining SST, a member state imposed its sales tax on formal wear, but exempted clothing generally. As part of its legislation to conform to the Agreement, the state made the decision to exempt all clothing. After being approved as a member state, the state imposes a tax specifically on the sale of formal wear at the same or a different rate than the state’s general rate of sales and use taxation. “Formal wear” is included within the definition of “clothing” in Part II of the Library of Definitions. The new tax requires sellers to file a separate return. This tax is a replacement tax because: (1) formal wear is included in the “clothing” definition, (2) the specific tax on formal wear was imposed in proximity to initiating action to become a member state, and (3) an additional administrative burden is imposed on sellers. The tax is also a prohibited replacement tax because it violates the fundamental purpose expressed in Section 102 of the Agreement.

Example 2 – A state authorizes local governments to impose a separate restaurant tax on "all prepared food or beverages sold by restaurants," as defined by ordinance. The restaurant tax has no use tax component. The local government also imposed its generally applicable sales tax on prepared food. Prior to the state's admission to the Governing Board, the sales tax definition of "prepared food" was modified to conform to the SST definition. The additional tax, however, continues to be imposed by local jurisdictions within the state just on sales by restaurants. Thus, restaurants still pay both the generally applicable sales tax and the restaurant tax on their meals. Grocery stores, however, and other non-restaurants, just pay the sales tax on any prepared food they sell. This tax is a not a replacement tax because the local tax was not imposed in proximity of the state initiating action to become a member state.

Example 3 – A state allows local governments an option to impose their local sales taxes on prescription drugs; such drugs are exempt from the state’s portion of the tax. The state has a two year legislative session. In the prior legislative session the state legislature repealed the local sales tax option on prescription drugs from the sales tax provision and enacted new legislation allowing local governments the option to continue to separately impose a local excise tax on a seller’s gross receipts from those drugs. The new law prohibits the local governments from imposing a use tax on such drugs. In the state’s current legislative session, the legislature formally initiates action to become a member state. The state makes no additional changes to the optional local excise tax on prescription drugs. The optional local excise tax on prescription drugs is a replacement tax because: (1) “prescription drugs” is a defined product, (2) removing the local option to tax prescription drugs from the sales tax was in proximity to initiating action to become a member state, and (3) an additional administrative burden is imposed on sellers. The tax is a prohibited replacement tax because while it does not have a use tax component, it still violates the fundamental purpose expressed in Section 102 of the Agreement.