A motion by Nebraska and South Dakota to adopt the best practices and corresponding best practices matrix under Sections 328 and 335 of the SSUTA relating to credits.

Best Practice Number 2 - Tax Credits

Term definitions for use in this Appendix

A. "**Product**" includes tangible personal property, a digital good or product transferred electronically, or a service.

B. "**Sales or use taxes**" mean the taxes that are commonly referred to as sales or use taxes that are paid to a state, local jurisdiction or to the District of Columbia that are based on a percentage of the sales price or purchase price. The states of Alaska, Delaware, New Hampshire, Montana, and Oregon do not impose taxes commonly referred to as state sales or use tax. Sales or use taxes do not include "similar tax".

C. **"Similar tax**" means a tax that is:

1. Imposed on the seller or purchaser;
2. Required to be, or which may be, collected from the purchaser at the time of the sale;
3. Based on a percentage of the sales price or purchase price of the product; and
4. Required to be paid by the purchaser directly to the state, if the seller was not required to remit the tax and the purchaser stored, used or otherwise consumed the product in the state.

Examples that may be similar taxes:

- motor vehicle excise taxes
- highway use tax
- scrap tire
- mill machinery taxes
- data center taxes
- manufacturing taxes
- farm and irrigation equipment excise taxes

D. **"Tax paid"** means the tax that was (1) paid and (2) previously due by either the seller or the purchaser when the sale of that product is taxable in that state and it was properly sourced based on that state's sourcing rules. "Tax paid" includes tax that was (1) paid and (2) previously due by the purchaser (or seller, if applicable) because the purchaser moved the product to a different jurisdiction. "Tax paid" does not include the portion of tax eligible for a credit or refund.

E. “Sales or use taxes paid” means the “sales or use taxes” that are “tax paid”.

Use of the term “State” in each practice refers to the state completing the Matrix.

The credit provided by a State will not exceed the total state and/or local sales or use tax due on a product in that State unless that state indicates otherwise.

Example of “Tax Paid” to Subsequent State:

- Purchaser receives a taxable product in State A for $1,000 and pays State A’s 5% sales tax, $50, to the seller.
- Purchaser uses the product in State B where the state sales and use tax rate is 6%. State B provides credit for sales or use tax paid on the initial purchase. Purchaser owes and pays State B $10 for sales or use tax. (($1000 x 6%=$60) - $50=$10)
- Purchaser then uses the product in State C where the state’s sales and use tax rate is 7%. State C provides credit for sales or use tax paid on the initial purchase and for taxes paid on use in a previous state. Purchaser owes State C $10 sales or use tax, as applicable. ($1000 X 7%=$70) - $60=$10.)

Example of “Tax Paid” Eligible for Refund:

- A purchaser buys, takes delivery of, and uses a piece of equipment in State A, which imposes a 5% sales tax.
- State A exempts equipment used in manufacturing. While purchaser’s use of the equipment qualifies for the exemption, the purchaser does not provide the seller with an exemption certificate. Therefore, the seller collects State A’s 5% tax on the sales price of the equipment.
- The purchaser uses the equipment in State B, where the sales and use tax rate is 6%. State B does not exempt the purchaser’s equipment from its sales and use tax.
- The purchaser can apply for and receive a refund of the 5% sales tax from State A.
- The purchaser owes State B 6% sales or use tax on the equipment.

Best Practice 2.1 Use Taxes Credited

The State imposing tax on the purchaser provides credit for “sales or use taxes paid” on a product against the State’s use tax.

<u>Best Practice 2.2</u> Sales Taxes Credited

The State imposing tax provides credit for the "sales or use taxes paid" on a product against the State's sales tax.

Credit for taxes paid on lease and rental transactions is provided for in Practices 2.14 – 2.16.

<u>Best Practice 2.3</u> Reciprocity

2.3.a. The State provides credit regardless of whether another state provides a reciprocal credit.

2.3.b. The State only provides credit when the other state where the tax was paid provides a reciprocal credit.

<u>Best Practice 2.4</u> State and Local Sales and Use "Tax Paid"

2.4.a. The credit provided for in 2.1 and 2.2 is for the combined amount of state and local "tax paid" to another state or local jurisdiction against both the state and local taxes due to the State.

2.4.b. The credit provided for in 2.1 and 2.2 is for only the state "tax paid" to another state against the taxes due to the State (i.e., no credit for local tax against state tax). If the State has local sales or use taxes, it only provides credit for state tax against state tax and local tax against local tax.

<u>Example A</u>

- Purchaser buys a taxable product from Seller in State A for $1,000.
- Purchaser takes possession of the product at Seller's location in State A.
- Seller collects State A's 5% state sales tax ($50) and 2% local sales tax ($20) on the transaction.
- Purchaser takes the product to State B where the state use tax rate is 4% ($40) and the local use tax rate is 4% ($40).
- State B gives credit for State A's 5% state tax paid against its 4% state use tax and gives credit for State A's 2% local sales tax paid against its 4% local use tax.
- State B will receive $20 in local use tax ($40 - $20) on this transaction.
- Purchaser paid a total of $90 in sales and use tax ($70 in State A and $20 in State B).

Best Practice 2.5 **"Similar Tax" Paid to Another Jurisdiction**

The credit provided for in 2.1 and 2.2 includes "similar taxes" that were (1) paid and (2) previously due to another state or local jurisdiction against the sales or use taxes due.

Credits for "similar taxes" are subject to the same restrictions and "tax paid" definitions in the best practice matrix as the credit for "sales or use taxes paid."

The State should list the "similar taxes" for which credit is allowed that are known to the State. The State should also indicate any other taxes it provides credit for even if such tax does not meet the definition of a "similar tax."

Example B

- State A imposes a 7% sales tax and State B imposes a 6% agricultural excise tax.
- The purchaser buys, takes delivery of, and uses farm machinery in State B and pays State B the agricultural excise tax.
- The purchaser subsequently uses the equipment in State A.
- State A imposes its tax on the machinery and provides credit for the agricultural excise tax paid to State B.
- The purchaser owes 1% sales or use tax to State A.

Best Practice 2.6 **"Similar Taxes" Imposed by the State**

The credit provided for in 2.1 and 2.2 includes "sales or use taxes paid" to another state or local jurisdiction against "similar taxes" due.

A state that provides credit against specific "similar taxes", but not all, should identify the "similar taxes" for which it provides credit against in the comments section of the Matrix. The State should indicate any other taxes it provides credit against even if such tax does not meet the definition of a "similar tax."

Example C

- State A imposes a 7% sales tax and State B imposes a 6% agricultural excise tax.
- The purchaser buys and takes delivery of farm machinery in State A and pays 7% sales tax to State A.
- The purchaser immediately moves the farm equipment to State B.

- State B allows credit for sales tax paid State A against the agricultural excise tax due on the farm machinery. No additional tax is due State B.

<u>Best Practice 2.7</u> Sourcing when Receipt Location is Known

The credit provided for in 2.1 and 2.2 applies when the other state's "sales or use taxes" were (1) paid and (2) previously due based on: i) that other state's sourcing rules, or ii) the purchaser's location of use of a product subsequent to the initial sale.

<u>Best Practice 2.8</u> Sourcing when Receipt Location is Unknown

Except as provided in Best Practice 2.13, the credit provided for in 2.1 and 2.2 applies when the seller sources the initial sale pursuant to the SSUTA Sections 310.A.3, 310.A.4, or 310.A.5, because the location where the product was received by the purchaser was unknown to the seller.

<u>Example D</u>

- A purchaser buys a digital product but does not provide seller with a delivery address. The seller collects 5% sales tax based on the purchaser's billing address in State A pursuant to SSUTA Section 310.A.3.
- The purchaser downloads the product in State B, where the sales tax rate is 7%.
- State A cannot refund the 5% tax to the purchaser.
- State B would allow credit for the 5% sales tax paid against the 7% use tax due. The purchaser would pay State B 2% use tax on the purchase.
- Since the 5% sales tax paid to State A is ineligible for refund, it is included in the definition of "Tax Paid".

<u>Example E</u>

- Same facts as Example D, except State A allows refunds to purchasers if it is documented the product is not taxable to their state – *e.g.* no delivery in State A.
- Because the purchaser can obtain a refund of the 5% from State A, it is not included in the definition of "Tax Paid."

State B would not allow credit for the 5% sales tax. The purchaser owes State B's 7% use tax.

<u>Best Practice 2.9</u> Characterization of Sale

The credit provided for in 2.1 and 2.2 applies regardless of the other state's characterization of the product as tangible personal property, a service, digital good, or product delivered electronically.

<u>Best Practice 2.10</u> Sales Price Components

2.10.a. Full Credit Allowed.

The credit provided for in 2.1 and 2.2 applies to all components of the SSUTA "sale price" definition, taxable and nontaxable in the State.

<u>Example F</u>

- State A includes delivery charges in its definition of "Sales Price".
- State B does not include delivery charges in its definition of "Sales Price".
- The purchaser buys equipment that is delivered in State A. The sales price of the product is $11,000, which includes $1,000 for delivery.
- The purchaser pays $550 sales tax to State A ($11,000 X 5% = $550).
- The purchaser uses the property in State B where the tax rate is 7%.
- State B provides full credit for $550 sales tax paid to State A.
- The purchaser pays an additional $150 use tax to State B. (($10,000 X 7% = $700) - $550 = $150).

2.10.b. Partial Credit Allowed

When taxable and non-taxable charges are itemized on the invoice, the credit provided for in 2.1 and 2.2 is only for the "tax paid" on the taxable components of the sales price in the State.

<u>Example G</u>

- State A includes delivery charges in its definition of "Sales Price".
- State B does not include delivery charges in its definition of "Sales Price".
- The purchaser buys a product that is delivered in State A. The sales price of the product is $11,000, which includes $1,000 for delivery. The delivery charge is itemized.

- The purchaser pays $550 sales tax to State A ($11,000 X 5% = $550).
- The purchaser uses the property in State B where the tax rate is 7%.
- State B provides credit for $500 sales tax paid to State A ($10,000 X 5% = $500).

- The purchaser pays an additional $200 use tax to State B (($10,000 X 7% = $700) - $500 = $200).

<u>Best Practice 2.11</u> Transactions with Taxable and Exempt Products

2.11.a. Full Credit Allowed.

The credit provided for in 2.1 and 2.2 applies to the full amount of "tax paid" on a transaction consisting of taxable and exempt products.

<u>Example H</u>

- Purchaser has a piece of equipment repaired in State A that imposes 4% sales and use tax on repair parts and repair labor. The purchaser pays $60 in sales or use tax, $500 for parts and $1,000 for labor (4% X $1,500 = $60).
- The purchaser uses the equipment in State B.
- State B imposes tax on repair parts at the rate of 7%; however, repair labor is not taxed.
- The tax due in State B on the repair parts is $35 (7% X $500).
- State B gives credit for the total tax paid to State A ($60) resulting in no additional tax being due in State B.

2.11.b. Partial Credit Allowed.

When taxable and non-taxable products are itemized on the invoice the credit provided for in 2.1 and 2.2 is only for the "tax paid" on the taxable products of a transaction in the State.

<u>Example I</u>

- Purchaser has a piece of equipment repaired in State A that imposes 4% sales and use tax on repair parts and repair labor. The purchaser pays $60 in sales or use tax, $500 for parts and $1,000 for labor (4% X $1,500 = $60).
- The purchaser uses the property in State B and uses it in a taxable manner. State B taxes repair parts at the rate of 7% but repair labor is not taxed.
- The tax due in State B on the repair parts is $35 (7% X $500 = $35).
- State B gives credit for the tax paid to State A on the repair parts ($500 X 4% =$20) resulting in $15 additional tax due State B ($35 - $20 = $15).

Example J

- Purchaser has equipment repaired in State A that imposes a 7% sales and use tax on repair parts, but excludes repair labor. The sale includes $500 for parts and $1000 for labor.
- The repair shop in State A collects and remits from the purchaser $35 sales tax on the parts ($500 X 7% = $35).
- The purchaser takes the equipment to State B that imposes sales and use tax on both repair parts and labor at 4%.
- The purchaser has a taxable use in State B that imposes $60 tax on the entire transaction for repair parts and repair labor ($1,500 X 4% = $60).
- State B gives credit for the tax paid to State A on the repair parts but only up to the rate impose in State B or 4% of $500 or $20. This results in $ 40 additional tax due on the labor ($60 - $20).

Best Practice 2.12 Audit Sampling

The credit provided for in 2.1 and 2.2 applies when the product was part of the population sampled pursuant to an audit sampling method.

Best Practice 2.13 Direct Mail

The credit provided for in 2.1and 2.2 applies when the seller sources the sale of Advertising and Promotional Direct Mail pursuant to Section 313.A.4.

Best Practice 2.14 Accelerated Payments on Lease/Rentals

The credit provided for in 2.1 and 2.2 includes the "tax paid" to another state or local jurisdiction on a lease/rental transaction based on the sum of the lease payments ("accelerated basis"), against the "sales or use taxes" due on the balance of the lease/rental payments.

Example K

- A purchaser enters into a leasing agreement in State A where the state tax rate is 5%. The agreement is for a three-year period with monthly lease payments of $1,000.

- State A imposes sales tax on an accelerated basis; collecting $1,800 in sales tax at the inception of the lease ($36,000 X 5% = $1,800). The property remains in State A for 12 months.
- In month 13, the purchaser moves the property to State B where the state tax rate is 8.0%.
- State B also imposes tax on an accelerated basis.
- The purchaser owes use tax at the rate of 8.0% on the remaining 24 lease payments or $1,920 ($24,000 X 8% = $1,920).
- State B allows credit for the $1,800 paid to State A. The purchaser owes an additional $120 to State B ($1,920 - $1,800).

Example L

- The same fact pattern as above except that State B imposes tax on the stream of lease payment each month.
- When the property is moved to State B in month 13, State B begins imposing tax on each payment or $80 per month.
- State B allows credit against the use tax due on the monthly payments until such time as the credit is exhausted; any remaining lease payments are subject to tax at the 8% rate.

Best Practice 2.15 Inception-Deferred Collection on Lease/Rentals

The credit provided for in 2.1 and 2.2 includes the "tax paid" to another state or local jurisdiction on a lease/rental transaction based on a deferred collection/remittance method against the "sales or use taxes" due on the balance of the lease/rental payments.

Example M

- A purchaser enters into a leasing agreement in State A where the state tax rate is 5%. The agreement is for a three-year period with monthly lease payments of $1,000.
- State A imposes sales tax at the inception of the lease but allows for deferred collection of the tax.
- The property remains in State A for 12 months; then is moved to State B where the tax rate is 8%. State A collects tax during the life of the lease.
- In month 13, the purchaser moves the property to State B where the state tax rate is 8.0%. State A continues to impose its 5% tax on the lease.

The lease payments which become due once the property is moved are subject to an additional 3% tax (8% - 5% = 3%).

<u>Best Practice 2.16</u> Lessor Acquisition

The credit provided for in 2.1 and 2.2 includes the "tax paid" by the lessor to another state or local jurisdiction on the acquisition of the product against the "sales or use taxes" due on the balance of the lease/rental payments provided the tax reimbursement is documented and disclosed to the lessee.

<u>Example N</u>

- A lessor purchases a piece of equipment in State A that will be leased to third parties. The tax rate in State A is 6%.
- State A allows the lessor to pay tax on its purchase price, $15,000, in lieu of collecting tax on the lease payments. The lessor pays $900 sales tax to state A ($15,000 X 6% = $900).
- The equipment is leased to a company for three years and the amount of tax paid is disclosed to the lessee.
- The lessee moves the equipment to State B which has a 7% state tax rate.
- State B would provide credit of $25 ($900/36 = $25) each month against the use tax due in State B.